The Culture of Consuming

Critical Review

An Interdisciplinary Journal *of* Politics *and* Society

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Jeffrey Friedman

ECONOMIC CONSEQUENTIALISM AND BEYOND

Because the cosmetic changes evident in this issue of *Critical Review* coincide with a change in its content, it may be a good time to review where the journal has been and explain where it is going.

Critical Review's history has had three phases, the third of which has just begun. It took the three years after our 1987 launching to discover that our modest initial goals were unattainable. We had aimed to bring radical free-market thought, then still on the intellectual fringes, into a bracing dialogue with mainstream economics, history, philosophy, political science, anthropology, and sociology. The aim was not only to make classical liberal ideas better known, but to test and strengthen them in the wind tunnel of learned criticism.

The Postmodern Detour

It soon became clear that this dialogue was taking place in only two disciplines, philosophy and economics—specifically, postmodern philosophy and Austrian-school economics. Once the inadequacies of postmodernism became apparent, it was clear why the other social sciences had been left out of our pages.

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A number of creative Austrian-school economists and libertarian philosophers had responded to our invitation to broaden the compass of classical liberalism by supporting, at some length,[1] the postmodern challenge to Truth and Science. They argued that this challenge was congruent both with the antipositivist methodological stance of the Austrian school, and with its repudiation of central planning. Since so few other classical liberals answered our call for papers (fortunately, nonlibertarians also participated), the libertarian side of *Critical Review* came to be dominated by recitations of the parallels between postmodernism and Hayekian liberalism.

This development exposed the weaknesses of contemporary classical liberalism more starkly than any point-by-point refutation might have done. For it highlighted the ideological imperatives that disable libertarianism. This may be surprising, in view of the leftist thrust of mainstream postmodernism. But it should be remembered that beginning with the Frankfurt school, the tendencies in the postwar European left that came to be called "postmodern" originated in a reaction against Stalinism. Hence the attacks on "the dialectic of Enlightenment" (Horkheimer and Adorno), "logocentrism" (Derrida), the "carceral society" (Foucault), the "metanarrative of modernity" (Lyotard), and so on were strikingly compatible with the libertarian repudation of statism and bureaucracy. (In his last years Foucault lectured on Mises and Hayek.) Moreover, the strictures of Hayek and Oakeshott against "constructivist rationalism" and "scientism" were in tune with the tendency of the European intellectual left to couch its emancipatory themes as refutations of Western *epistemology*.

These similarities—not to mention the self-undermining relativism of postmodernism—should have given pause to the classical liberal postmodernists. What becomes of Hayek's claim that the left relies on a hubristic understanding of reason, if today's left is resoundingly antagonistic to scientism and "the pretense of knowledge"? At best, Hayek's thesis becomes applicable to formerly existing socialism in the East and, in the West, to the likes of the British Fabians and the American Progressives. Central as these scientistic movements were in shaping the modern world,[2] they are very distant from postwar intellectual life—which demonstrates (as do Marx's humanist writings, upon which the Frankfurters drew)

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that scientistic rationalism is not a necessary aspect of the left-wing outlook.

What instead characterizes the left is the very quality on which classical liberals pride themselves: a commitment to individual freedom as the ultimate value. The difference between classical liberalism and the left is that the latter takes seriously the egalitarian premises implicit in the former. By shying away from the Stirnerite apotheosis of freedom for only one or a few individuals—instead embracing equal freedom for all—classical liberalism naturally leads to attempts to actualize freedom by redistributing the resources individuals need to freely pursue their projects. Libertarians who see themselves as oppression's most dedicated opponents fail to realize that their ideology is neither the opposite of leftism nor its most perfect embodiment, but its mild, superseded precursor. Hayek's exaggerated tale of the hegemony of a protosocialist "engineering mentality" after the French Revolution only obscures how logical the leftward progression away from classical liberalism was.[3]

By equating the left with "constructivist rationalism," Hayekians duplicate the postmodern left's equation of the bureaucratic state with "modernism." Like postmodernists using a critique of the Enlightenment to distance themselves from totalitarianism and technocracy, classical liberals use Hayek's critique of scientism to distinguish themselves from more consistent advocates of equal individual freedom to their left. Indeed, Hayek's attack on scientism as the source of modern ills could have been produced by the Frankfurt school—except that Hayek differentiates between the French Enlightenment, which he condemns as scientistic, and the Scottish Enlightenment, which he reveres.

In attempting to transcend scientism, however—going beyond a fallibilist and humanistic critique of positivism to repudiate the ideal of objectivity—postmodern Hayekians undermine the actual bases of their opposition to statism: claims about the objective nature of economic reality. In this way, the ideological need to deny the legitimacy of post-classical forms of liberalism unintentionally leads, by way of postmodernism, to the reinforcement of libertarianism's worst feature: its aprioristic approach to the question of the role of the state. For if there is no objective truth toward which empirical research into this question can lead us, then what purpose, except propaganda, does such research serve?

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From Postmodernism to Postlibertarianism

Between 1989 and 1994, *Critical Review* debated not only the emancipatory premises and metaphysical conundrums of postmodernism,[4] but, more significantly, the deficiencies in classical liberalism that had made some of its most creative adherents susceptible to postmodernism. Among these deficiencies are Hayek's narrative of constructivist rationalism and its antithesis, spontaneous order;[5] the unstable classical liberal mix of arguments for the benefits, and claims about the intrinsic value, of laissez faire;[6] and, in turn, the libertarian ideas that give rise to classical libertarian deontology.[7]

I have called the move from deontology to consequentialism "postlibertarianism." I did not choose this term because it describes a position born of criticizing *post*modern *libertarianism*. Rather, it refers to a new perspective achieved by passing through and, in Hegelian terminology, "sublating" libertarianism: that is to say, by experiencing and resolving the contradiction between libertarianism's consequentialist origins and its deontological conclusions.

Libertarianism originates in a posteriori free-market economic teachings that grew out of the generally utilitarian concerns of the Enlightenment (in its English, French, *and* Scottish variants). Libertarians superimpose on these teachings a fundamentally incompatible commitment to individual freedom as an intrinsic good. Libertarianism thus imitates the larger liberal pattern, in which the Christian preoccupation with freedom is severed from the Christian conviction that true freedom is to be found not in doing what one wishes, but in wishing and doing what is good. (Ironically, this liberal move toward deontology originally achieved the *teleological* good of civil peace against the threat of religious warfare.) When libertarians add, to the liberal endorsement of negative liberty as an end in itself, a conflation of negative liberty with private property, investigating the substantive effects of alternative economic systems becomes either pointless or valuable only as propaganda—just as with postmodern libertarianism.

Postlibertarianism is, then, an attempt by ex-libertarians not only to shed their previous normative commitments, but to reclaim what those commitments precluded: a determination to investigate the effects of capitalism on "the good." Postlibertarianism is not an ideology, but a research program undertaken by those who, be-

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cause of the decisive role of economics in libertarian thought, have experienced the characteristically liberal contradiction between apriorism and consequentialism with an immediacy that is unavailable to most liberals—and have chosen consequentialism.

"Antilibertarianism" might seem a better term than "postlibertarianism," but for two considerations.

First, consequentialism is truer to the roots of libertarianism than is libertarian doctrine itself. The initial impetus toward free-market conclusions was provided, after all, by arguments made by the Physiocrats, the Scottish political economists, and their followers in economics. In dismantling the deontological superstructure that has been erected atop those arguments, we want to reclaim the original Enlightenment commitment to unprejudiced empirical inquiry in the service of human well-being.

Second, nothing about consequentialism precludes libertarian policy conclusions—any more than it guarantees them. Wilhelm von Humboldt and, arguably, John Stuart Mill reached such conclusions using only consequentialist evidence, although, as a result, they could not limit the state as thoroughly as modern libertarians would like. On the other hand, postlibertarianism *can* mean antilibertarianism if valuable consequences can be shown to flow from exercises of state power. Among the *philosophes* were both paternalistic counselors to enlightened despots and pioneers of laissez faire. Everything turns on the contingencies of empirical research. Alongside the debate over postlibertarianism, accordingly, *Critical Review*'s second stage saw spirited exchanges between those who indicted government action and those who blamed market forces for economic problems.[8]

Among these debates has been a protracted excursus into the claims of "free-banking" economists that macroeconomic crises are not caused by the market economy, but by the state's regulatory efforts. This debate concludes, at least for now, with the contributions of Geoffrey Hodgson, George Selgin, Charles Kindleberger, and Steven Horwitz in the present issue. In future issues we hope to publish analyses of the effects of the Industrial Revolution on human welfare, and of the causes of unemployment, urban decay, and minority immiseration. We welcome submissions both from those who attribute these problems to market forces and those who suspect the state. (It should be mentioned that in an effort to foster nonideological research and reflection, we discourage papers that

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argue in favor of or against policy proposals, restricting ourselves to examining the genesis of social problems. Policy inferences are best left to our readers.)

From Postlibertarianism to Postliberalism

The third stage in *Critical Review*'s evolution, which began with our recent special issue on communitarianism,[9] expresses our growing awareness of the inability of economics to compare all the consequences of different social systems.

First of all, philosophy must determine what consequences are desirable; this explains the appearance, in a journal of political and social inquiry, of recent articles on beauty and art as goods.[10] The only "good" ruled out by the postlibertarian critique of deontology is freedom—not necessarily because freedom is not good, but because, as the mere ability to choose either goods or evils, it cannot be considered *intrinsically* good.

Assuming, however, something like the classical view that the highest good is happiness, evaluating social systems in terms of their consequences will mean comparing the degree of happiness, not just the amount of wealth, likely to flow from them. Recent articles on the possibilities for community within liberal society contribute to this task,[11] as do the papers in this issue by Robert E. Lane, James Q. Wilson, and Colin Campbell, which discuss whether or not the consumer society leads to human satisfaction. (These papers are somewhat schizophrenically juxtaposed against the ones on government financial regulation, which take for granted, as economics is licensed to do, that the maximization of wealth is desirable.) In future issues, sociologists, social psychologists, anthropologists, historians, and evolutionary psychologists will address topics that illuminate whether modernity in general, and capitalism in particular, have been conducive to happiness.

The suspicion that this is an improper or unwise line of inquiry will not, I believe, be confined to libertarian precincts. Liberals doubt that the task of political philosophy is to investigate the preconditions of happiness, as opposed to justice—or rather, they insist that the two be separated, so that justice consists in allowing to the individual the freedom to decide for him- or herself what happiness is, and how best to pursue it.

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The liberals' preference for formal over substantive political theory is, however, as disloyal to their foundational concerns as the classical liberals' sanctification of laissez faire is to their underlying commitment to human welfare. Liberals of all stripes tend to distort their commitment to equal well-being by inquiring into how to ensure not well-being, but its proxies: the ability to pursue one's chosen goals through equal access to wealth, employment, education, political participation, and, more recently, through the resources made available by one's cultural identity.

Ensuring that people can pursue whatever it is that they decide is good—through their ballots, their purchases, or their unmolested freedom of action—only maximizes well-being if one assumes that people desire well-being; that they know how to achieve it; and that they are able to achieve it, given the proper distribution of resources within a society whose basic contours are modern. These are empirical claims that, surely, require substantiating evidence. Yet Lane's article suggests that even in their personal decisions, people are widely mistaken about what makes them happy. Similarly, Schumpeter, anticipating much recent public-opinion research (to be discussed in these pages), suggested that in making political decisions, we are, all of us (politically engaged intellectuals as well as the disengaged majority), abysmally lacking in information that would render democratic public policy rational.[12] Further evidence of political irrationality is abundant, at least at first glance, when one examines the phenomenon of nationalism—the subject of a forthcoming special issue of *Critical Review*. In some tension with this view, but not necessarily at odds with it, are rational-choice approaches to political behavior, which also will be debated in a special issue.

A Schumpeterian disdain of democratic competence does not necessarily mean, of course, that there is a better alternative to democracy; it may well, however clumsily, best ensure at least—or rather, at most—that gross errors in government are eventually corrected. Schumpeter may, however, provide an as-yet undeveloped reason to worry about conferring vast responsibilities on the state: competent action may decline as the decisionmaker—bureaucratic or democratic—gets farther from the particulars.

Nor does Lane's view entail that the state should micromanage people's personal affairs; even acknowledging that folly is ubiquitous, a strict prohibition against paternalistic legislation could be

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based on the tendency of such legislation to produce even worse outcomes than leaving people alone. But precisely why should that be the case? Lane's arguments *might* justify state paternalism if evidence of its counterproductivity is lacking, and especially if there are systemic conditions that frustrate even well-informed individual efforts to make wise choices.

Because postlibertarianism has led us to a concerted attempt to broach these issues, *Critical Review* may be interesting to more readers than those merely curious to observe the autocritique of libertarianism (by some accounts, the latest fad to sweep politics in the United States).[13] Important as the differences are between libertarianism and social democracy, it remains true that both are species of the liberal approach to politics that has not only dominated the West for two centuries, but continues to spread across the world. Libertarianism illustrates the tension between the teleological and deontological aspects of liberalism in an arresting form. Postlibertarian inquiries may, therefore, prove instructive to scholars who haven't the slightest interest in free markets or private property as topics in their own right.

NOTES

1. A skeptical and nuanced appropriation of postmodernism is found in Dennis Auerbach, "Liberalism in Search of Its Self," *Critical Review* 1, no. 3 (Summer 1987): 7–29. The quite different approach criticized in the text is exemplifed by Tom G. Palmer, "Gadamer's Hermeneutics and Social Theory," ibid., 91–108, at 102–107; Don Lavoie, "Polanyi's Critique of Objectivity," ibid., 109–116, at 114ff; Donald N. McCloskey, "The Two Cultures and Methodology," ibid., 124–27; G. B. Madison, "Postmodern Philosophy?," *Critical Review* 2, nos. 2–3 (Spring-Summer 1988): 166–82; idem, "Hayek and the Interpretive Turn," *Critical Review* 3, no. 2 (Spring 1989): 169–87; idem, "How Individualistic Is Methodological Individualism?," *Critical Review* 4, nos. 1–2 (Winter-Spring 1990): 41–60; Gregory R. Johnson, "Hermeneutics: A Protreptic," ibid., 173–211; James D. McCawley, "The Dark Side of Reason," *Critical Review* 4, no. 3 (Summer 1990): 377–85; and Madison, "The Politics of Postmodernity," *Critical Review* 5, no. 1 (Winter 1991): 53–80. In a similar vein, see Peter J. Boettke, *Why Perestroika Failed: The Politics and Economics of Socialist Transformation* (New York: Routledge, 1993), 144; and David L. Prychitko, *Marxism and Workers' Self-Management: The Essential Tension* (New York: Greenwood Press, 1991), passim. The two postmodern approaches confront each other in an exchange between Auerbach and Palmer in *Critical Review* 2, no. 1 (Winter 1988): 144, 146–47.

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2. One wonders, as well, whether the fact that the Fabians, Progressives, and Leninists were able to draw on scientistic currents of thought was a *necessary* condition of their scientistic proposals. It could be argued, I believe, that "constructivistic" policies are simply intuitive responses to social problems in societies where there is a recognized locus of supreme authority (i.e., a state).
3. F. A. Hayek, *The Counter-Revolution of Science: Studies in the Abuse of Reason*, 2nd ed. (Indianapolis: Liberty Press, 1979). I criticize Hayek's view in "The New Consensus: II. The Democratic Welfare State," *Critical Review* 4, no. 4 (Fall 1990): 633–708, at 696–97n51; and in "After Libertarianism: Rejoinder to Narveson, McCloskey, Flew, and Machan," *Critical Review* 6, no. 1 (Winter 1992): 113–52, at 142–44. The logical progression from classical to leftist liberalism presented by Durkheim, Simmel, and Lorenz von Stein is summarized in my "Cultural Theory as Individualistic Ideology," *Critical Review* 7, no. 1 (Winter 1993): 129–58, at 150–51.
4. See *Critical Review* 5, no. 2 (Spring 1991), a special issue on postmodernism; Donald N. McCloskey, "Minimal Statism and Metamodernism," *Critical Review* 6, no. 1 (Winter 1992): 107–12; Jeffrey Friedman, "After Libertarianism," ibid., at 140–46; Raphael Sassower and Joseph Agassi, "Avoiding the Posts," *Critical Review* 8, no. 1 (Winter 1994): 95–111; Ingrid Harris, " 'Instincts into Sacred Cows': Are Hermeneutical Universals *Reducible* to Agreement?," ibid., 113–36; Jeffrey Friedman, "Truth and Liberation," ibid., 137–57.
5. See Friedman articles cited in n2 above, and Laurent Dobuzinskis, "The Complexities of Spontaneous Order," *Critical Review* 3, no. 2 (Spring 1989): 241–66. Also see pp. 84–88 of Dallas Clouatre's "Making Sense of Hayek," *Critical Review* 1, no. 1 (Winter 1987): 73–89, the most penetrating critique of Hayek that has been published anywhere, as far as I know; and Robert J. Antonio, "Reason and History in Hayek," *Critical Review* 1, no. 2 (Spring 1987): 58–73.
6. Friedman, "The New Consensus: II," at 661–66; W. William Woolsey, "Libertarianisms: Mainstream, Radical, and Post," *Critical Review* 8, no. 1 (Winter 1994): 73–84; David L. Brooks, "The Problems of Postlibertarianism," ibid., 85–94.
7. Auerbach, "Liberalism in Search of Its Self"; Ryszard Legutko, "Society as a Department Store," *Critical Review* 4, no. 3 (Summer 1990): 327–43; Friedman, "The New Consensus: II," at 638–660; Jan Narveson, "Libertarianism, Postlibertarianism, and the Welfare State," *Critical Review* 6, no. 1 (Winter 1992): 45–82; Antony Flew, "Dissent from 'The New Consensus,' " ibid., 83–96; Tibor R. Machan, "The Right to Private Property," ibid., 97–106; Friedman, "After Libertarianism," ibid., 113–52.
8. For examples, see *Critical Review*'s special issues on Keynesianism (Summer-Fall 1989), the welfare state (Fall 1990 and Fall 1993), big business (Fall 1991), environmentalism (Spring-Summer 1992), and the regulatory state (Spring-Summer 1993).

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9. *Critical Review* 8, no. 2 (Spring 1994).
10. Warren Shibles, "Humanistic Art," *Critical Review* 8, no. 3 (Summer 1994): 371–92; Laurie Calhoun, "Institutions and Deviance: Art and Psychiatry," ibid., 393–409.
11. Peter Simpson, "Liberalism, State, and Community," *Critical Review* 8, no. 2 (Spring 1994): 159–73; James Hudson, "Individual and Community," ibid., 175–216.
12. Joseph Schumpeter, *Capitalism, Socialism, and Democracy*, 3rd ed. (New York: Harper and Row, 1950), 256–68; Philip E. Converse, "The Nature of Belief Systems in Mass Publics," in David Apter, ed., *Ideology and Discontent* (New York: Free Press, 1964), 206–61; and the vast post-Converse literature (for example, most recently, Benjamin I. Page and Robert Y. Shapiro, *The Rational Public* [Chicago: University of Chicago Press, 1992]).
13. E.g., Gerald F. Seib, "Libertarian Impulses Show Growing Appeal among the Disaffected," *Wall Street Journal*, January 10, 1995: A1, A4; E. J. Dionne, Jr., "Libertarians' Lure," *Washington Post*, December 6, 1994.

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Colin Campbell

CONSUMING GOODS AND THE GOOD OF CONSUMING

The tendency to denigrate consumerism derives from the widespread acceptance of sociological theories that represent consumers as prompted by such reprehensible motives as greed, pride, or envy. These theories are largely unsubstantiated and fail to address the distinctive features of modern consumption, such as the apparent insatiability of wants and the preference for the novel over the familiar. A more plausible view of consumerism regards it as an aspect of hedonism, and links consumption to the widespread practice of daydreaming. Seen in this light, one can discern an idealistic dimension to modern consumption.

There has long been a tendency in both academic and intellectual circles to devalue, and often to denigrate, that field of human conduct which falls under the heading of "consumption." This is due to the existence of a powerful tradition of thought that generally regards consumption with some suspicion, inclining us to believe that, even if it is not exactly "bad," it can have nothing whatever to do with that which is good, true, noble, or beautiful.

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Two factors can be identified as largely responsible for this attitude of suspicion. One is the discipline with which the term "consumption" is most commonly associated: economics. For it is inherent in the basic paradigm adopted by economists that *production* is singled out as the activity that matters. Although in theory consumption is the sole end and justification for all production, it is quite clear that production, not consumption, is the more valued and morally justifiable activity. A second reason for the bias in favor of production is to be found in that Puritan inheritance which itself gave rise to modern economics (if indirectly, via utilitarianism), and that, more pertinently, also encouraged successive generations to place work above leisure, thrift above spending, and deferred above immediate gratification. It is this generalized asceticism that is largely responsible for the contemporary denigration of consumption.[1]

However, even the Puritans did not condemn all consumption; what they accepted as legitimate was consumption directed at satisfying needs, while fiercely condemning any expenditure in excess of what was deemed necessary to meet these needs. In other words, it was luxury consumption which was roundly condemned, not consumption in general. One of the main reasons modern consumption has such a bad press is that it is generally seen to be mainly "luxury" or "want-based" in character. Consequently, even the little moral legitimacy consumption once possessed has today largely been swept away.[2]

In contemporary society, then, there are essentially two attitudes toward consumption. First, it may be viewed as a matter of satisfying "genuine" needs (what we may call "basic provisioning"), in which case, even if this is considered a mundane matter of routine, day-to-day decision-making and habit, it is at least seen as a legitimate activity by most intellectuals. Alternatively, consumption is viewed as largely a matter of gratifying wants and desires by means of goods and services that are viewed as nonessential (that is, luxuries), in which case it is typically regarded as an arena of superficial activity prompted by ethically dubious motives and directed toward trivial, ephemeral, and essentially worthless goals.

Now there are two distinct yet closely associated points to note about this latter attitude. The first concerns the idea that want-driven consumption concerns the "unnecessary" and hence the unimportant things in life; this leads to condemnations of consump-

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tion on the grounds that it involves people in superficial or frivolous activities. Consumption is thus contrasted with "real," significant activities such as work, religion, or politics. The second and related point is that involvement in trivial activities, and especially the tendency to take them seriously, is assumed to stem from questionable motives: no one guided by high-minded or noble concerns, it is assumed, would ever become involved in such dubious pursuits. Consequently, consumption is viewed as the realm in which the worst of human motives prevail—motives such as pride, greed, and envy. Any social scientist who wishes to understand consumption is forced to confront both of these moral judgments, since they are central to most theories of consumption.[3]

The question, therefore, is whether our understanding of the activities of consumption does indeed justify the condemnation with which it generally meets. In short, is consumption bad for us? In addressing this question, one is not concerned with whether consuming is harmful in the literal sense that our health or well-being is threatened by the nature of the items we consume. Rather, the focus is on the claim that consuming is deleterious because it is an activity (or a set of activities) that "brings out the worst in us"; that is to say, because it encourages us to behave in morally reprehensible ways. Does consumption lead us to be greedy, materialistic, avaricious, or envious? The predominant concern is with the motives (and to a lesser extent the goals) that are presumed to underlie modern consumption behavior.[4]

The thesis advanced here will be that the usual antipathy toward the motives of consumption is, if not entirely without justification, extremely one-sided, if only because the social science theories that buttress it are hardly plausible. Close attention to why people actually do consume goods suggests the presence of an idealistic, if not exactly ethical, dimension. Therefore, we must first outline a somewhat different view of the nature of consuming in contemporary industrial (or postindustrial) society from those which currently prevail.

Modern Consumption

Why people consume goods is understandably a central question for social science. Essentially, there have been two general answers

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to this question—one economic, the other sociological. The inadequacies of the economic paradigm (in which the origin of wants is simply not explored) have been well documented elsewhere and will not be pursued here. On the other hand, the sociological model, which in practice means Thorstein Veblen's model, is still widely employed and its inadequacies are rarely noted.

In essence, Veblen's model assumes that consumption is a form of communication in which "signals" concerning the wealth (and thus, it is argued, the social status) of the consumer are telegraphed to others. In addition, it is assumed that individuals seek to use such "conspicuous consumption" as a way of improving their social standing, aiming ultimately to "emulate" that "leisure class" which, it is claimed, stands at the pinnacle of the class system. This view of consumption links it directly with an ethically dubious activity, social climbing. In assuming that consumers' main interest in goods is as symbols of status, Veblen asserts that consumers are motivated by a mixture of anxiety (over how others may view them) and envy (of those in a superior position). It is hardly surprising that, with the widespread acceptance of such a theory, consuming is commonly viewed as ethically suspect.

There are, however, many problems with Veblen's model, which generally can be said to be theoretically incoherent where it is not empirically false.[5] The key deficiency is that it does not account for the dynamism that is so typical of modern consumption. Status competition through conspicuous display does not require novel products; it coexists happily with an unchanging, traditional way of life.[6] In this respect, both the economic and the sociological models have the same central failing: they attempt to provide an ahistorical general theory that fails to recognize crucial differences between traditional and modern consumption. The question is not, Why do people consume? Rather it is, Why do we consume as we do? That is to say, why do *modern* individuals consume as they do?

The Problem of Consumerism

It is a fundamental mistake to imagine that modern consumption, or consumerism, is simply traditional consumption writ large, as if all that separates the two phenomena was a question of scale.

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Therefore, it is misleading to assume that modern consumption equals mass consumption. Consumption in modern societies may well be consumption "for the masses," something that could not occur until modern techniques made large-scale production possible; but what really distinguishes it is its dynamic character. The very high levels of consumption typical of modern societies do not stem primarily from the fact that large numbers of people consume; rather, they stem from the very high levels of individual consumption, which in turn stem from the apparent insatiability of consumers and the fact that their wants appear never to be exhausted. While technological innovation and planned obsolescence both have a part to play in keeping consumption levels high, the greatest contribution is consumers' almost magical ability to produce new wants immediately after old ones are satisfied. No sooner is one want satisfied than another appears, and subsequently another, in an apparently endless series. No modern consumer, no matter how privileged or wealthy, can honestly say that there is nothing that he or she wants. It is this capacity to continuously "discover" new wants that requires explaining.

What makes consumerism even more puzzling is that we typically discover that we desire novel products, ones with which we are unfamiliar. We cannot possibly know what "satisfaction" (if any) such products might yield when we desire them. Indeed, it would seem that it is principally this preference for novel goods and services that lies behind the apparent inexhaustibility of wants itself, as manifest, for example, in the central modern phenomenon of fashion.

These, then, are the features that distinguish the modern from the traditional consumer. The latter generally tends to have fixed needs rather than endless wants, and hence consumes the same products repeatedly, as and when these needs arise. This pattern of consumption does not, as economists often seem to imply, simply result from the lack of resources to consume more. Rather, the pattern represents all the consumption that the "needs" dictated by traditional ways of life require.[7] The problem to be addressed when attempting to account for modern consumption, therefore, is how it is possible for inexhaustible wants—often wants for novel products and services—to appear with such regularity.

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A Hedonistic Approach

It is possible to provide at least a partial solution to this problem by regarding modern consumption activity as the consequence of a form of hedonism. In saying this, it is important to recognize that what is meant by hedonism or pleasure-seeking has nothing in common with that theory of satisfaction-seeking, deriving from utilitarianism, which traditionally underlies most economic theories of consumption.

The latter model is built around the idea that human behavior is concerned with the elimination of deprivation or need. Consequently, it assumes that individuals interact with objects so as to make use of their "utility" to "satisfy" these "needs." Such conduct may bring pleasure to the individual, but not only is this not guaranteed, it is not the reason the object was desired. Thus, economic theory is not centrally concerned with pleasure-seeking behavior. The principal reason for this is that whilst utility is a real property of objects, pleasure is a judgment that individuals make about stimuli they experience. As such, pleasure is not necessarily connected with extracting utility from objects. Trying to satisfy needs usually requires engaging with real objects in order to discover the degree and kind of their utility in meeting pre-existing desires. Searching for pleasure means exposing oneself to certain stimuli in the hope that they will trigger an enjoyable response. Hence, whilst one typically needs to make use of objects in order to discover their potential for need satisfaction, one need only employ one's senses to experience pleasure. What is more, whereas an object's utility is dependent upon what it is, an object's pleasurable significance is a function of what it can be taken to be. Only reality can provide satisfaction, but both illusions and delusions can supply pleasure.

However, since the elimination of basic human needs is generally experienced as pleasurable (as in the experience of eating when one is attempting to eliminate the deprivation caused by hunger), pleasure-seeking has traditionally been perceived as bound up with efforts to meet needs. This perception becomes less valid as the advance of civilization causes fewer people to experience the frequent deprivation of their basic needs, so that the pleasure associated with need-fulfilment tends to become more and more elusive.[8] The traditional hedonist's response is to try to recreate the gratificatory cycle of need-satisfaction as often as possible.

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Traditional hedonism hence involves a concern with "pleasures" rather than with "pleasure," there being a world of difference between valuing an experience because (among other things) it yields pleasure, and valuing the pleasure an experience can bring—that is, focusing upon a distinct aspect or quality of the experience. The former is the ancient pattern. Human beings in all cultures seem to agree on a basic list of activities that are "pleasures" in this sense, such as eating, drinking, sexual intercourse, socializing, singing, dancing, and playing games. But since pleasure is a quality of experience, it can, at least in principle, be judged to be present in all sensations. Hence the pursuit of pleasure in the abstract is potentially an ever-present possibility, provided that the individual's attention is directed to the skillful manipulation of sensation rather than to the conventionally identified sources of enjoyment.[9]

Modern Hedonism

All too often, then, it has been assumed that hedonistic theories of human conduct emphasize sensory pleasures. This, however, is not necessarily the case, for although all pleasure-seeking can be said to have a sensory base, there is no reason that hedonism should concentrate exclusively, or even primarily, on the "baser" appetites. Indeed, while an emphasis on the sensory may have characterized traditional hedonism, it is not characteristic of its contemporary counterpart; modern hedonism focuses less on sensations than on emotions.

Emotions have the potential to serve as immensely powerful sources of pleasure, since they constitute states of high arousal. Any emotion—even the so-called negative ones, such as fear, anger, grief, and jealousy—can provide pleasurable stimulation. However, for the stimulation associated with such emotions to be experienced as pleasant, the extent of the arousal must be adjustable: it must be possible for the individual to "control" the emotion. An ability to self-regulate emotion is much more than a mere capacity to suppress (though this is its starting point), but extends to the "creation" of a given emotion at will.

Such emotional cultivation is achieved largely through the manipulation of what an individual believes to be the nature of his or her condition or environment, particularly through adjustments in

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the degree to which certain things are held to be the case. For example, to the extent that people can convince themselves that they have been harshly treated by life and don't deserve their bad luck, they will be able to enjoy the "pleasure" of self-pity. To a large extent, however, the deliberate cultivation of an emotion for the pleasure derived from experiencing it does not center around efforts to reconstruct what is believed about the real environment in this way. Rather, it tends to focus on the somewhat easier task of conjuring up imaginary environments that are sufficiently realistic to prompt an associated emotion. This modern, autonomous, self-illusory hedonism is called, in everyday language, daydreaming.

Daydreaming

Daydreaming is an integral part of the psychic lives of modern men and women, yet there is a tendency either to ignore its presence and/or to deny its importance. Nearly everyone in modern society both daydreams and fantasizes; this is a regular, daily activity for both sexes and all ages.[10]

Yet there has been little recognition of the importance of this phenomenon or of the fact that it is characteristically a modern practice, largely dependent on the development of individualism, literacy (that is to say, silent reading), and the novel. There is little doubt that the impulse lying behind daydreaming is a hedonistic one, as individuals turn away from what they perceive as an unstimulating real world in order to dwell on the greater pleasures imaginative scenarios can offer. In this context, the individual can be seen as an artist of the imagination, someone who takes images from memory or the immediate environment and rearranges or otherwise improves them so as to render them more pleasing. Such daydreams are experienced as convincing; that is to say, individuals react subjectively to them as if they were real (thereby gaining an emotional response), even while realizing that they are not. This is the distinctly modern faculty the ability to create an illusion: that is known to be false but felt to be true.

Generally speaking, the way reality is typically adjusted by the daydreamer so as to give pleasure is by simply omitting life's little inconveniences, as well as by adding what, in reality, would be happy (if not extraordinarily unlikely) coincidences. In this way,

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imagined experience characteristically comes to represent a perfected vision of life, and from what are often quite small beginnings, individuals may develop daydreams that become "alternative worlds"—that is, elaborate works of art—deviating more and more from what might reasonably be expected of reality.

Although daydreaming is commonly dismissed as an inconsequential phenomenon, there are grounds for believing that it has significant effects. For example, although daydreaming is typically prompted by boredom, the pleasures it supplies mean that daydreamers are likely to experience "real life" as more boring than they did before, increasing the probability that further daydreaming will occur. Thus, like all forms of pleasure, day-dreaming can easily become addictive and result in a certain tendency to withdraw from ordinary life.

However, daydreaming differs from straightforward fantasizing in that it concerns events and scenarios that might actually occur at some point in the future. Indeed, daydreams often begin with simple, anticipatory imaginings surrounding real, upcoming events, such as holidays. This makes it more or less inevitable that actuality is going to be compared—in terms of pleasure gained—against the standard set by the anticipatory daydream, and hence generally experienced as (quite literally) disillusioning. For no matter how pleasant the real-life experience turns out to be, it is impossible for it to resemble the perfection attained in imagination. Consequently, disillusionment is very likely to prompt still more daydreaming, and thus, inevitably, further disillusionment. This suggests that daydreaming creates certain permanent dispositions: a sense of dissatisfaction with real life and a generalized longing for "something better."

The Spirit of Modern Consumerism

Such an understanding of the dynamics of how dreams and experiences of real life interact may make it possible to explain those mysterious features of modern consumerism identified above. These include not simply the question of where wants come from (and indeed go to), but also how it is that consumers have an inexhaustible supply of them, and why it is that they have such a strong preference for novel, as opposed to familiar, goods. We can

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now suggest that modern consumers will desire a novel rather than a familiar product, largely because they believe its acquisition and use can supply them with pleasurable experiences that they have not so far encountered in reality. One may project onto the novel product some of the idealized pleasure that has already been experienced in daydreams, but that cannot be associated with products currently being consumed (as the limits to the pleasure they provide are already familiar). For new wants to be created, all that is required is the presence in the consumer's environment of products that are perceived to be new.[11] Hence, we can say that the basic motivation underlying consumerism is the desire to experience in reality that pleasurable experience the consumer has already enjoyed imaginatively.

Only new products are seen as offering any possibility of realizing this ambition. But since reality can never provide the perfected pleasures encountered in daydreams (or, if at all, only very occasionally and in part), each purchase naturally leads to disillusionment; this helps explain how wanting is extinguished so quickly, and why people disacquire goods almost as rapidly as they acquire them. What is not extinguished, however, is the fundamental longing that daydreaming itself generates. For the practice of daydreaming continues (and indeed may be strengthened), and hence there is as much determination as ever to find new products to serve as replacement objects of desire.

This dynamic interplay between illusion and reality is the key to an understanding of modern consumerism (and modern hedonism generally), for the tension between the two creates longing as a permanent mode, with the concomitant sense of dissatisfaction with what is and the yearning for something better. Daydreaming turns the future into a perfectly illusioned present. Hence, individuals do not so much repeat cycles of sensory pleasure-seeking (as in traditional hedonism) so much as they continually strive to close the gap between imagined and experienced pleasures. Yet this gap can never be closed, for whatever one experiences in reality can be adjusted in imagination so as to be even more pleasurable. Thus the illusion is always better than the reality, the promise more interesting than actuality.[12]

This theory of consumerism is inner-directed. It does not presume that consumption behavior is either guided by, or oriented to, the actions of others. In that sense, it breaks with the long-standing

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sociological tradition that presents consumption as an essentially social practice.[13] On the other hand, this theory does not present consumption as driven by material considerations. The idea that contemporary consumers have a magpie-like desire to acquire as many material objects as possible (the acquisitive society thesis) represents a serious misunderstanding of the basic motivational structure that leads consumers to want goods. The acquisitive society thesis is particularly at odds with the facts, for modern consumer society is characterized as much by the extent to which individuals dispose of goods as the extent to which they acquire them. Consumerism involves a high *turnover* of goods, not merely a high level of their acquisition. This fact is consistent with the claim that the true focus of desire is less the object itself than the experience the consumer anticipates possessing it will bring.

Consumerism and the Counterculture

By extricating modern consumption from its presumed connection with other-directed status striving and envy on the one side, and crude materialism and acquisitiveness on the other, an understanding of this sphere of activity may be reached that does not automatically carry with it overtones of moral disapproval or condemnation. Unfortunately, this aim does not appear to have been achieved, since, by closely associating consumption with hedonism, it seems inevitable that consumerism will remain an object of moral disapproval. Indeed, one could claim that the present theory only makes matters worse, as, in some quarters at least, pleasure-seeking is even more objectionable than the consumption of "luxury" goods. Certainly we can say that, on the whole, pleasure has been the one constant target of moralists over many generations, largely because of the hostile attitude originally taken by the early Christian fathers and typically still held in our own day by fundamentalists and other representatives of the religious right.[14]

There is, however, an alternative moral tradition that not only defends the pursuit of pleasure, but associates it directly with the highest moral and spiritual ideals. This tradition of thought was represented historically by Antinomianism and then, in more recent times, by Romanticism. It is still very much alive, with its last

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significant efflorescence occurring in the 1960s in the form of the movement we know as the "counterculture."[15]

Central to the Romantic creed is the belief that the true and the good are both subsumed under the beautiful, and consequently that they, too, are to be discerned by means of the imagination. It also follows that these ideals, like beauty itself, can be recognized by their capacity to give pleasure, with the natural consequence that the path to virtue and enlightenment is identical with the pursuit of pleasure. This is recognizable as the faith that inspired many of the young counterculturalists of the 1960s; yet it is only fair to observe that they were hardly renowned for their defense of the consumer society. On the contrary, they launched the very critique of commercial and material values that has, to a large extent, laid the basis for much of our current unease about the state of modern life. While the counterculturalists defended pleasure-seeking, they also attacked what they saw as the evil of consumerism. How is this paradox to be explained?

To some extent it can be accounted for by the fact that the counterculturalists, like the spokespersons for the conventional morality they claimed to reject, held to that erroneous view of the nature of consumption mentioned above. Hence, they accepted the assumption that consumerism involved status envy, acquisitiveness, and materialism, whilst being perhaps understandably reluctant to recognize that their own high valuation of pleasure might be connected in some way with their experience as the first generation to be reared in a climate of widespread affluence.

In contrast to this explanation of the paradox, what one might call the "official" explanation is that the Romantic identification of pleasure with the ideal realm of virtue and beauty means that there is an understandable hostility to any trivialization or "prostitution" of this central dimension of human experience—hostility, in other words, to any tendency to treat the pursuit of pleasure as a simple end in itself, a mere "recreation" in which push-pin could be regarded as on a par with poetry. Thus, the Romantics' principal objection to consumption (it is said) was not that it was prompted by a search for pleasure (even less that it gave pleasure), but that pleasure seeking was not being taken seriously enough. In other words, Romanticism gives the highest possible legitimation to the pursuit of pleasure, especially the pursuit of imaginatively mediated pleasure, whilst condemning not merely simpleminded and

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crass pleasures, but hedonism itself, when it is not associated with a high moral purpose.

The Goods of Consumerism

However, to suggest that one can approve of pleasure-seeking when it is part and parcel of the pursuit of high ideals, yet disapprove of it when, separated from such ideals, it is engaged in simply for personal gratification, presumes that it is possible to tell which is which. Unfortunately, this is not so easy. For example, the practice of taking drugs, especially LSD, was defended by many in the 1960s on the grounds that it was an important means of attaining enhanced self-awareness and spiritual enlightenment. But for many hippies and quasihippies, drugs were probably used with no such end in view, but simply because of the "high" they yielded. It is difficult to distinguish between these two positions because, in practice, they often merge into one another; or perhaps, more accurately, the one can easily become the other over time. Individuals may set out to take drugs merely to gain a high, only to find that their awareness is transformed; or, alternatively, those who take drugs because they hope to attain enlightenment might, on the contrary, merely develop an addiction to a particular form of intense physical stimulation.

It might be objected that this is to make heavy weather of what is really a fairly simple matter, since as far as most consumption activity is concerned, purely selfish, or at least self-interested, motives are obviously at work. Unfortunately for this argument, the presence of selfish interests is not incompatible with more high-minded concerns. Whilst some consumption is merely a matter of mundane provisioning, much of it is of considerably less prosaic interest to those involved. Obviously, buying a house, a car, a boat, or a set of furniture is, for most people, an act of some moment, linked to what might be considered their "life projects." Understandably, then, major purchases of this kind often figure prominently in people's thoughts, where they play a crucial role as both incentives and rewards. In other words, such acts of consumption are critically interwoven into the motivational structures of individuals, providing the energy they need to carry through difficult tasks as well as the gratification necessary if they are to believe

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subsequently that their efforts were worthwhile. In this direct and obvious sense, not merely actual consuming, but also imaginary, "anticipatory consuming" can indeed be said to be good for us, since without it, we might lack good reasons for doing anything at all.

It does not necessarily follow, however, that because purchasing goods plays such an important part in the reward system of individuals, there is no idealistic or ethical dimension present in those projects around which individuals organize their lives. After all, although people's daydreams differ, a common factor, apart from the quality of pleasure, is the representation of the dreamer in an idealized manner. Thus, the pleasure people derive from daydreaming is not separate from their moral life; it is intimately associated with it: doing good—or more accurately, perhaps, imagining oneself doing good and being good—often constitute an important part of the pleasures of daydreaming.

In this respect, the pleasures associated with imagining perfect scenarios relate directly to imagining oneself as a perfect person, one who exemplifies certain ideals. This point can be illustrated by considering two important aspects of modern consumption: fashion and tourism.

The theory outlined above helps explain why modern consumers should be so eager to "follow fashion," without, however, having to resort either to the implausible suggestion that they are forced to do so, or that they are merely striving to "keep up with the Joneses." Since fashion is an institution that guarantees the controlled introduction of a degree of novelty into goods with high aesthetic significance, the taste for novelty generated by the widespread practice of self-illusory hedonism helps explain the importance and persistence of this institution.

Unfortunately, there has been a consistent tendency for intellectuals to decry fashion, to treat it as a trivial, insignificant, even worthless phenomenon. Yet if we use the term properly, to refer to a consistent process of changes in style (rather than simply a synonym for custom or practice), opprobrium is entirely inappropriate. For fashion necessarily involves an aesthetic ideal, and those who dedicate themselves to keeping up with fashion—or even more interestingly, perhaps, to "taking the lead in fashion"—can be said, quite justifiably, to be striving to bring their lives into line with the ideal of beauty. That there may be an element of narcissism in-

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volved, or that the conduct in question may be strengthened by the presence of such motives as pride or vanity, does nothing to negate the ideal dimension of such behavior, since all forms of moral conduct probably require the helping hand of self-interest. "Following fashion" may indeed, in some instances, be little more than a mindless and morally worthless endeavor, but it can also be the high-minded pursuit of a serious ideal.

Much the same can be said of tourism, which is increasingly becoming a central component, not merely of modern consumerism, but of modern life. Tourism does not involve the purchase of products, but of experiences; yet, as with fashion, novelty is the most critical quality in defining the parameters of desire. Here, too, there has been a tendency in some circles to caricature and despise the "tourist" whilst celebrating, by contrast, the genuine "traveller." But this bias is hard to justify, since the acquisition of valued experiences is crucial to the goals that find favor in modern society (and especially, perhaps, in the contemporary United States). The human potential and encounter-group movements of the 1960s and 1970s, as well as their successors, the quasireligious and psychotherapeutic movements of the 1990s, stressed the importance of critical "experiences" in helping individuals to discover their "true selves" and hence maximize their potential. Such phrases are also often to be found in statements defining the goals of education, therapy, and art. If the acquisition of "experiences," especially those of a highly novel kind, is accorded such critical importance in contexts such as these, how is it that it should be denied this status when occurring under the heading of "tourism"?

Is Consumption Good for Us?

I do not know. Such a question suggests both that we can agree on what constitutes the good life and that we know exactly what effects our current consuming practices are having on ourselves and our society. In addition, it is difficult to speak of "consumption" as if it were a single, undifferentiated activity. However, as I have tried to show, there is something distinctive about modern consumption. By elucidating this I have endeavored to shed some light on whether the motives and goals embedded in such activity

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can be considered good. Obviously there is no simple answer, for consumerism is a complex phenomenon.

However, it is clear that both self-interested and idealistic concerns are involved in consumerism. Indeed, consumerism is prompted by concerns and guided by values that underpin many other modern institutions, yet which, in those other contexts, are usually regarded favorably. It is not as if the theory I have outlined applies only to consumption. It applies with equal force to all forms of behavior in which imaginative pleasure-seeking or desire plays a significant role. Romantic love is one such phenomenon, so one could ask, with equal justification, whether love is good for us.[16]

Hence, it is delusory to imagine that one can cordon off consumption from the larger moral and idealistic framework of our lives and dub it "bad" without, in the process, significantly affecting the total moral landscape of our world. Consumerism probably reflects the moral nature of contemporary human existence as much as any other widespread modern practice; significant change here would therefore require no minor adjustment to our way of life, but the transformation of our civilization.

NOTES

1. Another moral dimension to this discussion is associated with gender. Much consumption activity (especially shopping) has long been seen as primarily "women's work," whilst production has been judged "men's work." This can also be seen as a major influence on the ethical judgments passed on consumption.
2. It has often been suggested that a new "ethic" has arisen that serves to legitimate consumerism: see William H. Whyte, *The Organization Man* (New York: Doubleday-Anchor Books, 1957); David Reisman et al., *The Lonely Crowd: A Study in the Changing American Character* (New York: Doubleday-Anchor, 1966); and Daniel Bell, *The Cultural Contradictions of Capitalism* (London: Heineman, 1976). Tellingly, such claims are made by writers who do not themselves endorse the new ethic, but, on the contrary, seek to condemn it, often from a perspective of apparent support for the old ascetic Protestant values. Consequently an attitude of suspicion, if not hostility, toward consumerism still typifies academic and intellectual discussions in this field.
3. This view sometimes places the blame on individuals for engaging in such practices, while at other times it exonerates them by arguing that consumers are typically coerced or manipulated into this form of behavior by others (usually manufacturers or advertisers). In either case, however,

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consumerism itself is judged to be bad, whether the source of the evil lies in individuals or in the organization of the society.

4. This extremely negative view of modern consumption is not typically shared by consumers themselves; indeed, one suspects that it is not actually shared by academics and intellectuals, either, when actually acting as consumers. In fact, there has recently been a movement among intellectuals and some academics to view consumerism as far more significant; see Steven Connor, *Postmodernist Culture: An Introduction to Theories of the Contemporary* (Oxford: Blackwell, 1989); David Harvey, *The Condition of Postmodernity* (Oxford: Blackwell, 1989); Mike Featherstone, *Consumer Culture and Postmodernism* (London: Sage, 1991); and Frederic Jameson, *Postmodernism, Or the Cultural Logic of Late Capitalism* (London: Verso, 1991). Here, there is a tendency to regard consumption as the central focus of the efforts of individuals to create and maintain their personal identity. However, despite this development, there is little evidence of any change in moral tone. For such conduct is still likely to be despised, if not actually condemned.
5. In the first place, the picture of a single leisured elite whom all other classes seek to emulate (either directly or indirectly) inaccurately portrays the complex stratification system of modern societies. Second, what determines the consumption habits of this elite remains a mystery, as *they* have no one to emulate. Third, new fashions in the consumption of goods do not always or even commonly originate with a social elite and then "trickle down" the status ladder as a result of imitation and emulation by those in inferior positions. In fact, fashions "trickle up" or even "across" just as often as they trickle down (see Paul Blumberg, "The Decline and Fall of the Status Symbol: Some Thoughts on Status in a Post-Industrial Society," *Social Problems* 21 [1974]: 480–98). Fourth, social standing is not determined simply by wealth (let alone only by conspicuously displayed wealth); other qualities, most obviously birth, can still be important. Finally, treating wealth and leisure as equivalents, both signifying "waste," is seriously misleading given the important Protestant tendency to applaud the first whilst deploring the second, as well as the Bohemian inversion of this view. For a full account of the emulation model of consumption see Thorstein Veblen, *The Theory of the Leisure Class* (London: George Allen & Unwin, 1925); for a critique, see Colin Campbell, "The Desire for the New: Its Nature and Social Location as Presented in Theories of Fashion and Modern Consumerism," in *Consuming Technologies: Media and Information in Domestic Spaces*, ed. Roger Silverman and Eric Hirsch (London: Routledge, 1992), and idem, "Conspicuous Confusion? A Critique of Veblen's Theory of Conspicuous Consumption," *Sociological Theory* 12, no. 2 (1994).
6. See, for example, Melville J. Herskovits, *Economic Anthropology: A Study in Comparative Economics* (New York: Alfred A. Knopf, 1960).
7. See Elizabeth E. Hoyt, "The Impact of a Money Economy upon Consumption Patterns," *Annals of the American Academy of Political and Social*

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Science no. 305 (1956); 12–22; and Kusum Nair, *Blossoms in the Dust: The Human Factor in Indian Development* (New York: Frederick A. Praeger, 1962).

8. See the argument in Tibor Scitovsky, *The Joyless Economy: An Inquiry into Human Satisfaction and Consumer Dissatisfaction* (New York: Oxford University Press, 1976).
9. These two orientations involve contrasting strategies. In the first, the basic concern is with increasing the number of times one is able to enjoy life's "pleasures"; thus the traditional hedonist tries to spend more and more time eating, drinking, having sex, and dancing. The hedonistic index here is the incidence of pleasure per unit of life. In the second, the primary object is to squeeze as much of the quality of pleasure as one can out of all the sensations one actually experiences during one's life. All acts are, from this perspective, potential pleasures, if only they can be approached or undertaken in the right manner; the hedonistic index here is the extent to which one is actually able to extract the fundamental pleasure that "exists" in life itself.
10. See J. L. Singer, *Daydreaming* (New York: Random House, 1966).
11. Products need not actually be new; they merely have to be presented or packaged in such a way that it is possible for consumers to believe they are new.
12. That there is a close relationship between people's daydreams and their selection, purchase, use, and disposal of goods and services is revealed, for example, by the nature of advertisements. But one should not assume from this that advertising *creates* daydreaming, as the latter appears to be an intrinsic feature of the mental life of modern humans and does not depend on external agencies to prompt or support it.
13. See Veblen and Riesman.
14. To suggest that consumerism is driven by pleasure-seeking is to raise the possibility that ecological and anticonsumerist movements might have something in common with earlier Puritanical movements. Perhaps an important underlying (if not openly admitted) impulse behind such movements might indeed be a hostility to pleasure. Could such movements represent a new Puritanism in their calls for us to sacrifice our energy-expensive and "wasteful" way of life?
15. See, for the Romantic nature of this movement, Colin Campbell, *The Romantic Ethic and the Spirit of Modern Consumerism* (Oxford: Blackwell, 1987); Frank Musgrove, *Ecstasy and Holiness: Counter-Culture and the Open Society* (London: Methuen, 1974); and Bernice Martin, *A Sociology of Contemporary Cultural Change* (London: Blackwell, 1981).
16. The question has of course been posed before, and the answer much debated. See Jacqueline Sarsby, *Romantic Love and Society* (Harmondsworth: Penguin, 1983); Ethel Spector Person, *Love and Fateful Encounters: The Power of Romantic Passion* (London: Bloomsbury, 1989); and Stanton Peele, *Love and Addiction* (New York: Taplinger, 1975).

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Robert E. Lane

THE ROAD NOT TAKEN: FRIENDSHIP, CONSUMERISM, AND HAPPINESS

Since the mid-1960s in advanced and rapidly advancing economies, there has been a rising tide of clinical depression and dysphoria, a decline in mutual trust, and a loosening of social bonds. Most studies show that above a minimal level, income is irrelevant to one's sense of well-being, but companionship and social support increase well-being. Since shopping and consumption are increasingly solitary activities, and watching television is not genuinely sociable, the increased time devoted to these activities may be responsible for rising levels of depression. Advanced societies are likely to increase "utility" if they maximize friendship rather than the getting and spending of wealth.

Since the mid-1960s there has been an unprecedented increase in clinical depression in advanced and rapidly advancing economies. This paper addresses the question: Does the market economy, with its "rage to consume" (Durkheim's "dreams of fevered imagination"), contribute to the growing prevalence of depression? After

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exploring the evidence regarding the increase in depression and its substantial costs, I will examine what seems to be a most important cause of depression: lack of friends or confidants, that is to say, a decline in "social support." I look at the other side of the coin, as well: how the presence of friends one can count on influences happiness. The crucial influence of family solidarity on happiness is not discussed here.

Turning to the relation between markets and friendship, I will explore the costs and benefits of assigning priority to friendship over commodities and examine whether, and if so how, the market inhibits friendship and other kinds of social support. Both materialist and affiliative motives drive people to pursue commodities and friendship; each motive has its advantages and defects. Examining these motives, I ask if there is any type of demand for more friendships comparable to the demand for more commodities. Finally, I explore reasons for and solutions to the friendship deficit that seems to be a principal cause of depression. Thus, the first part of the article explicates the nature and causes of our debilitating social malady, while the second deals with how our patterns of consumption influence the malady and how social support might relieve it.

Lest my references to "happiness" (as the obverse of depression) lead to misunderstanding, I will note at the outset that in my cosmology there are *three* final goods, not one. Happiness (and the relief of that most unhappy state, depression) is the one treated here. But human development and justice are equally important. This paper is not an effort to rescue utilitarianism; the happy society is not necessarily the good society.

I. AFFLUENCE AND DEPRESSION

Consider some evidence of the growing incidence of depression in economically advanced democracies. "In some [advanced] countries," it was recently reported, "the likelihood that people born after 1955 will suffer a major depression—not just sadness, but a paralyzing listlessness, dejection and self-deprecation, as well as an overwhelming sense of hopelessness—at some point in life is more than three times greater than for their grandparents' generation."[1] A large nine-nation study finds that this epidemic is characteristic of

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rapidly modernizing countries, such as Taiwan, as well as such economically advanced countries as Germany and New Zealand.[2] Since World War II, each succeeding generation in these advanced and rapidly advancing economies is more likely to be depressed, for, as Martin Seligman has reported, "depression has not only been getting more frequent in modern times, but it occurs much earlier in life the first time."[3]

While the United States is not the most depressed country in the world,[4] it may be on its way to that infelicitous rank. On the basis of two earlier (1982, 1985) epidemiological studies funded in the United States by the Alcohol, Drug Abuse, and Mental Health Administration involving a total of about 12,000 people in 1982 and 1985, a U.S. rate of increase in depression much higher than the rates of other countries seems evident: "People born after 1945 were 10 times more likely to suffer from depression than people born 50 years earlier."[5] Myrna Weissman and her associates report research covering five sites in the United States with similar, but less startling, results. These authors find "an increasing risk of depression at some point in life for younger Americans. For example, of those Americans born before 1955, only one percent had suffered a major depression by age 75; of those born after 1955 six percent had become depressed by age 24." [6] This finding corresponds to an earlier report of a six-year study tracking 956 American men and women: those under forty were three times more likely to become severely depressed than were older groups.[7] The Weissman study suggests that about a quarter of the population now experiences some of the clinical symptoms of depression at least once over a lifetime.[8] Because all mental illness is painful, it is relevant that Ronald Kessler reports evidence showing that during their lifetimes almost half of the population (48 percent) will experience some kind of mild or severe mental illness, of which major depression is the most common.[9]

Studies of mood disorders in children are even more disturbing. For example, one study in Britain finds a 42 percent increase of mood disorders from 1985 to 1990 among children under ten years of age.[10] Reports from the United States indicate similar increased childhood rates, adding that childhood depression is a strong indicator of later depression in adulthood.[11] Since children of the depressed are much more likely themselves to be depressed,[12] a malign, self-reinforcing cycle seems to envelop us.

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Major depression is not just a matter of mood. The recently standardized test for depression used in the nine-nation study mentioned above includes such further criteria as insomnia, loss of energy, hypertension, "loss of interest or pleasure in usual activities," "feelings of worthlessness, self-reproach, or excessive or inappropriate guilt," and "recurrent thoughts of death, suicidal ideation, wishes to be dead, or suicide." One classic formulation focuses on the trinity of hopelessness, helplessness, and worthlessness.[13] Although depression and anxiety are separate illnesses, most research reports link the two. Hopelessness is said by some to be the key variable.[14]

Let us take a skeptical moment to question the reliability and validity of these studies of rising depression. One reason for questioning them is that although measures of subjective well-being (happiness, satisfaction with life-as-a-whole) are, as we might expect, closely and inversely related to depression at any one time,[15] over time they do not track the measures of rising depression. I believe that this discrepancy between simultaneous and diachronic measures is because the happiness measures are more sensitive to the adaptation phenomenon, whereby people take as a standard their current or very recent moods, whereas the depression measures are not similarly sensitive. In any event, the measures of depression are more reliable than the simpler measures of happiness (in general surveys, often tapped by a single question). Other reasons for believing that the measures of rising depression are both reliable and valid are these: (1) The reliability of self-reports of depressive episodes has been demonstrated in careful retests of depression assessments after a four-year period.[16] (2) The studies of depression do not rely on visits to therapists (which are contaminated by self-selection), but rather on massive surveys of the general public. (3) Independent studies using the same standardized instruments come to the same conclusions. (4) Physical symptoms (fatigue, eating disorders), which are less vulnerable to trends in the "fashionability" of mental illnesses, support the diagnoses. (5) Studies of children, who are not aware of what they "should" report, also support the diagnoses. Finally, (6) instead of an overcount of cases of depression, there may well be an undercount due to the prevalence of "masked depression."[17]

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Friendship, Social Integration, and Depression

The absence of friends and of family solidarity is the crucial explanatory variable for depression, just as their presence is a central explanatory factor for happiness. Citing a 1976 study published by the Department of Health, Education, and Welfare, James S. House argues that friendship and kin relationships, which provide "information leading the subject to believe that he is cared for and loved, that he is esteemed and valued, and that he belongs to a network of communication and mutual obligation, appear to reduce the levels of stress experienced, improve health, and buffer the impact of stress on health."[18] A major study specifically focused on depression finds that "depressives reported a lack of confidants both within and outside the household to a significantly higher degree than controls."[19] Both the *loss* of friends and the chronic *absence* of friends seem to have similar damaging effects on positive well-being, although the sudden loss of friends and family ties is more closely associated with the onset of depression. Depressives also have weaker social networks than the nondepressed.[20] A study of the elderly found that in addition to smaller friendship networks, the depressed had fewer associational memberships and weaker church affiliations.[21] Thus, although most studies find the lack of *confidants* to be a primary source of depression—and a primary buffer against the damaging effects of stress—weaker but more extensive relationships sometimes serve a purpose similar to that of confidants. Finally, since low self-esteem is both a symptom and a cause of depression, it is worth noting again that one important source of low self-esteem is the inadequate interpersonal relations that are, in turn, the source of the debilitating absence of friends and confidants.[22]

The causal sequence is important for the purposes of this study: if depression is a primary cause of loss of friendship and of social networks, then our hypothesis that a society cultivating commodities instead of friends will cause depression is weakened, for the absence of friends and of strong social networks would itself be caused by whatever caused depression. To some extent this is the case, inasmuch as it has been shown that as depressives recover, their social relations improve, and when they relapse, their social relations deteriorate.[23] On the other hand, some studies have shown that social networks, closely associated with the incidence

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and prevalence of depression, are themselves determined not by the skills and choices of the persons involved but largely by "culturally determined rules."[24] And others show that life events that reduce available social support *precipitate* onsets of depression.[25] The most conclusive evidence of the role of friendship (or other intimate relationships) comes from microstudies of the onset of depression: if a woman has even a single confidant she can survive, without depressive illness, the hardships and traumas that precipitate depression in other women not so happily befriended.[26] Finally, cognate studies of subjective well-being (happiness) find that when circumstances change, so that a person is included in a social group, his mood and sense of well-being increase substantially;[27] and that number of friends is a far better predictor of subjective well-being than is level of income or wealth.[28] Thus, although there is much evidence that the depressed have poor social skills and that their very symptoms of helplessness and worthlessness inhibit their search for friends, when they are included in social groups or befriended by others, their symptoms improve. The same is true of the merely unhappy.

Apart from the decline of the family, has there been a decline in close friendships or a weakening of social networks during the postwar period of rising depression? There is little doubt that there has been a general postwar decline in intimate relationships, visiting among neighbors, and membership in secondary associations. House reports that as of 1976, consistent evidence "indicates that the prevalence of significant informal social relationships, networks, and supports has been declining over the last quarter century while people are increasingly calling on those same sources of support for help in dealing with personal problems."[29] We know that belonging to a variety of voluntary groups (such as fraternal orders, sports groups, church-related groups, and the League of Women Voters) is at least associated with a lowered vulnerability to depression, and these memberships have declined during the postwar period. For example, those with no such memberships increased from 25 percent in 1967 to 35 percent in 1993.[30] Church attendance is related to subjective well-being and to lower vulnerability to depression;[31] in the 1960s there was a sharp decline in church attendance, followed by a plateau at a lower level.[32] And, while in 1974, 72 percent of those questioned said they visited with their neighbors more than once a year, in 1993 only 61 percent engaged in this form of socializ-

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ing.[33] (One should note, however, that in a British study comparing neighbors to friends and members of the family, neighbors rated lowest in degrees of reciprocal help, warmth, and contribution to the enjoyment of leisure activities.)[34]

We seem warranted in concluding that there has been an alarming increase in depression, with its associated feelings of helplessness, hopelessness, and worthlessness, in rapidly advancing and advanced countries, especially in the United States; that the loss of social support of all kinds is a cause as well as a consequence of depression; and that there has been a postwar decline in many forms of social support and of social integration. We must now consider how changes in income may influence both happiness and depression.

Income, Happiness, and Depression

In proposing to substitute friendship for commodities, we need to know what degree of well-being is lost by slighting the economic side of life. Devaluing economic pursuits in favor of greater companionship is likely to cause a loss of income, which, of course, is the means for buying and therefore for consuming commodities. Although earning, possessing, buying, and consuming have somewhat different hedonic statuses, by summarizing evidence from a variety of studies, we can say that for the non-poor this complex of economic goods has only a modest relationship to subjective well-being.[35]

There is ample evidence that within advanced economies, the rich are no happier than the less rich. In general, above the poverty line, happiness (or its pale, vulgar companion, average "utility") does not change much or at all as level of income increases. For most people above the poverty line, money does not buy (much, if any) happiness. Elsewhere I have documented this claim and called the assumed correlation between happiness and level of income (above the poverty level) "the economistic fallacy."[36] Put differently, if "utility" has anything to do with happiness, then above the poverty line, and even more so in the United States than in Britain, the long-term marginal utility of money is almost zero. Adam Smith knew this: "In ease of body and mind, all the ranks of life are nearly upon a level."[37]

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But "mere" unhappiness is not depression. Is the relationship of income to depression the same as the relationship—or lack of it—between income and happiness? Among the poor, both unhappiness and depression are more prevalent than they are among those who are more affluent. The circumstances of poverty contribute to insecurity, stress, worry, and, for some, an inability to cope with unfavorable life events, and hence to helplessness and hopelessness. Whether depression is influenced by level of income *above* the poverty level is less clear, although at least one study reports that "the higher the socioeconomic status, the lower the level of [psychological] distress."[38] Another, smaller study reports the same relationship between socioeconomic status and depression, but finds that all demographic variables together accounted for only 12.6 percent of the variance.[39] Earlier studies (which do not include the sharp increase in depression in the 1960s) tend to support the income-depression relationship,[40] but almost all observers add to the influence of inadequate material resources the possibly greater influence of the relatively impoverished social relations of the poor,[41] including a characteristic "lack of intimacy in the working class"[42] that inhibits working-class people from acquiring that single, all-important confidant.

Does depression tend to cause lower socioeconomic status (the "social drift" hypothesis), or does socioeconomic status cause depression? A longitudinal study using 1952 and 1968 data assessed this question and found that, on balance, the evidence favored the view that low social status was more a cause than a consequence of depression. It also found that, during those sixteen years, there was not much change in either factor: "not only did depression tend to persist, but its relationship to low SES also tended to endure."[43]

Without conducting a thorough cross-cultural analysis here, we should note that although people in rich nations are happier than those in poor nations,[44] the current epidemic of depression seems to be striking the advanced countries more than the less economically developed ones. Thus, Seligman reports that "on the whole, you do not find much in the way of depression as we know it—suicide, hopelessness, giving up, low self-esteem, passivity, and the like—in nonWestern cultures before they are modernized." He cites a 1984 study of New Guinea and an older study of the American Amish as evidence that the complex of things called "modernity," including the self-attribution and self-blame common to market societies,

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must cause some of the depression not experienced by LDC populations.[45] Similarly, Mexican-born immigrants to the United States have a lower incidence of depression than American-born Mexican-Americans.[46] (Earlier cross-national studies failed to find this Western–non-Western difference in mental illness, but they relied on pre-1965 data.)[47]

Unhappiness and especially depression have social as well as personal costs: there is substantial evidence that unhappy people, compared to happy ones, are not only harder to live with but also less effective at school and at work.[48] The spouses, children, and friends of the depressed suffer even more;[49] the depressed lose interest in everything but their misery; their judgment, understanding,[50] social responses, and capacity to work[51] are all impaired; they are more vulnerable to other disorders such as panic attacks;[52] their more frequent absences from work are costly to their firms;[53] and their treatment and occasional hospitalization impose heavy costs on their families, governments, and society in general.[54] I will not detail these costs and losses here, but, in addition to the intrinsic value of lost well-being, these burdens give urgency to the search for causes and cures of the social illnesses of market societies.

Conversely, let me suggest six reasons why a priority for friendship over commodities is a promising route to happiness, an effective protection against depression, and a step toward a more benign environment.

1. There is evidence that the pleasures of commodities are more satiable than the pleasures of friendship. Because people adapt easily to increased levels of commodity consumption, as Durkheim pointed out a century ago, consumerism dooms us to walk a hedonic treadmill that will never satisfy us. In contrast, the pleasures of friendship seem to increase with experience.

2. Although rivalry for friends is common, and among lovers has the unpleasant status of jealousy, in general, friendship is a variable-sum game: when I gain a friend, others do not necessarily lose one. Indeed, a friend of mine is more accessible to other friends of mine—a positive-sum game. Because friendship is almost infinitely expandable (the community may become a more friendly place), new friendships do not decrease the supply; and the "price" of friends does not tend to increase when the demand increases. Economic growth confers these felicitous properties upon some commodities, but the process is slower, such that in the short run,

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consumers are faced with a modified zero-sum game. Economics is said to be a science of coping with scarcity; it is not so with friendship.

3. Self-esteem, the most important disposition associated with happiness and a prime protector against depression, is unrelated to levels of income[55] (and therefore to levels of consumption), but it is closely related to friendship—or rather, self-esteem has its most important source in intimate groups.[56]

4. While the reward system among friends has its drawbacks (conformity, risk-aversion, favoritism, fear of exclusion), it also has many advantages. Among friends the reward for effort or excellence is praise, whereas market rewards are in money. Praise is more likely to be interpreted as information than as control, and is therefore welcome, whereas money rewards are more often interpreted as control and, at least where the work being rewarded is intrinsically satisfying, control is often resented.[57]

5. Friendship is a known source of happiness and a protection against, and even cure for, depression; while higher levels of income increase well-being only among the poor.

6. Finally, compared to material consumption, friendship is ecologically friendly.

II. MARKET CULTURE AND FRIENDSHIP

Assuming that we would rather be happy than depressed, and accepting that it is the loss or absence of companionship, friends, and satisfying, enduring family relationships that account in substantial part for the rise of depression, what could have happened to keep us from pursuing the relationships that lead to happiness? One possibility is that we have been distracted, not so much by manipulating merchants as by the gap between the abundance of goods capitalism has made available to us, on the one hand, and, on the other, the preoccupation with scarcity that is our inheritance from millennia of hunter-gatherer and peasant life. What is now true only of the poorest fifth of the population within advanced economies was once true of all but a tiny elite: more material resources are a prime source of happiness. But why do we not learn from experience that this is no longer the case?

The central assumption of market economics regarding con-

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sumer choice is that people pursue one line of goods until the "marginal utility" of some other line of goods is greater than that of the first one. At that point people switch, and they go on doing this until the marginal utilities of all goods they can afford are equal. Experience teaches them over time what the respective utilities of various goods may be; that is, the learning curve is such that people can equalize their utilities over a reasonably short space of time, short enough to avoid heavy sunk costs. If this picture is accurate, why would people pursue commodities that do not make them happy at the expense of friends, whose solace and joy would make them happier and reduce their chances of depression?

One fundamental problem is the perfect knowledge assumption of market theory. Economic theories of market-generated felicity fail to allow that *people often do not know* what makes them happy. Of course, the pursuit of happiness is not wholly blind—but it is myopic. Although resisted by almost everyone, the theory of a disabling myopia in the pursuit of happiness, with suitable specification of modifying conditions, is supported by very strong evidence.[58] Among other reasons for widespread resistance to the myopia theory is undoubtedly the fact that it violates both market and democratic theory and threatens the cherished tenets of individualism.

This is not the place for a review of the evidence of our ignorance of the sources of our own well-being, but some of the psychological tendencies that encourage our perverse preference for commodities over friendship may be briefly mentioned. People tend to prefer short-term to long-term gains—a familiar source of addiction. Thus, one inhibition to learning the true sources of happiness is the short-term pleasure caused by gains in income and consumption. The hedonic yield of money and commodities may be instantaneous, whereas the utility from friendships, and especially from intimacy, takes longer to become evident. Also, market comparisons require the "measuring rod of money." The lack of prices attached to friendship makes it difficult to compare the hedonic yields of friendship and commodities.

Moreover, friendship depends on intrinsic worth, but market exchange, of necessity, values only extrinsic, public worth. As Roy Harrod points out, friendships, unlike commodities and money, cannot be traded. Economics and, we might add, economic calculations performed by noneconomists, are "concerned only with the goods and services of which the constituent items can be made

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alternatively available to one or [an]other of different persons. Thus goods like friendship and mystical experiences are excluded."[59] Again, market exchange places no value on sunk costs, but friendship is very often dependent on sunk costs which, among friends, are valued in themselves and for the memories of good times or tribulations shared together. And finally, as Marx pointed out, people pursue money to compensate for failed friendships or disappointment in love, but under these circumstances money fails to satisfy. When people recover from their depression or other mental illness, they often give up their exclusive pursuit of money and goods and look to their relations with people.[60]

The priesthood of economists, whose vision is fixed by the model of priced market transactions, has allies in the advertisers who reinforce the belief that the good life is achieved only through consumption. These forces create a set of conventional beliefs through which we explain our actions to ourselves. It has been well established that we often interpret our behavior and even our moods by reference to conventional theories about what causes or should cause any given mood or behavior, rather than to independent causal theories developed through and tested against personal experience and privileged knowledge of our internal states.[61]

All of this may explain the fundamental ignorance of the sources of our own happiness—and, though less often, of our depressive feelings—which makes us willing to substitute commodities for friendships.

Are Markets "Cold Societies"?

Some, like Simmel, hold that the market has created a "cold society" whose rationality undermines the emotional warmth necessary for friendship.[62] Marx and Lukács, Fromm and Marcuse believe in *commodification* theories: in market economies people are treated as commodities from which to extract as many utilities as possible. In the late 1970s and again in 1991 I argued against the view that markets had this effect on human relations.[63] New evidence has now changed my mind on this issue. Let us briefly examine the competing arguments and evidence.

Smith and Hume argued that markets free human relations from instrumental calculation by separating instrumental, self-interested

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relationships from what they called the "sympathetic" relationships in which people had previously been entangled. "If that is correct," writes Allen Silver, "commercial society promotes rather than discourages personal relations that are normatively free of instrumental and calculative orientations."[64] Indeed, it could be argued further that where the market allocates goods, human relations, freed of this burden, can concentrate on the emotional aspects of friendship. But, because sympathy and empathy are learned early in the family, the breakup of the family is likely to make this theory inoperative in modern societies.

A second line of defense against Simmel's indictment points to the inconclusiveness of the evidence of loneliness and the manipulative treatment of friends in modern society, and highlights countervailing tendencies. Experts on city life have suggested that friendship networks are taking the place of neighborhoods and communities. Higher education is associated with better human relations; with the help of market-created affluence, educational levels have greatly increased over the years. While the geographical mobility encouraged by markets might be expected to undermine friendships, the fact is that people who move from one locality to another tend, after five years, to have as many good friends in the new place as the old one—and often they move in order to be nearer members of their families. In any event, it is not at all clear that geographic mobility increased in the past century, and certainly not in the past fifty years. Finally, the evidence of suspicion and conflict in pre-industrial villages and traditional and primitive societies make a secular trend toward cold or conflictual relations seem unlikely. All of this evidence will be examined below.

A failing of the Marx-Lukács-Fromm theory that we treat each other as commodities is that its underlying theory of the easy transfer of (commodifying) behavior from domain to domain is weak. Although this issue has been much disputed, the current consensus among psychologists is that situational variation alters much behavior, such that people naturally change their behavior to meet the demands of different situations.[65] If people compartmentalize their behavior, market relationships need not contaminate friendships.

Additional arguments and empirical studies show that instead of demanding purely calculating behavior, markets require interpersonal trust. "Without an integrative framework," as Kenneth Boulding points out, "exchange cannot develop, because exchange

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. . . involves trust and credibility."[66] Empirical studies support this claim. They find that interpersonal trust is a condition not only for market exchange but also for economic modernization, industrial efficiency, and the delay of gratification, and that it is at least associated with the sense of personal efficacy that contributes so much to well-being.[67] In spite of the extensive humanistic criticism of the market as the source of distrust, Alex Inkeles and Larry Diamond's comparison of human traits in modern and less modern countries finds "a strong positive association between economic development and a psychological disposition to trust other people."[68]

New Evidence Against the Market

More recent studies, however, lend support to the market's critics. The Harris poll has for thirty-three years asked the following question: "Some say that most people can be trusted while others say that you can't be too careful in dealing with people. Which do you believe?" From 1960 to 1993 there was a steady downward trend in the percentage of respondents who say they trust "most people," from a high point in 1960, when 58 percent gave this response, to a low in 1993, when only 37 percent did so.[69] Can the postwar decline in interpersonal trust be laid at the doorstep of the market?

Two models of friendship interpret interpersonal affiliation as a series of market-like processes: the reinforcement model and the social exchange model.[70] If either or both of these market-like models correctly interpret friendship relations in a market society, it is, indeed, likely that as Simmel believed, the market erodes the social support that is both a protection against depression and a source of happiness.

The reinforcement model has two versions, one inimical to the idea of friendship as a relation between people who intrinsically value each other, the other compatible with the idea of intrinsic worth but still making friendship contingent on other factors. The first, the operant contingency reinforcement theory made famous by B. F. Skinner, holds that "attraction [to another] is based on the positive affect accompanying reinforcement,"[71] where reinforcement is some act or expression by another that the self regards as favorable (flattering, helpful, value-reinforcing, etc.). According to this theory, friendship can be seen as a modified market exchange: I

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do something and you pay me for it. The second reinforcement theory (one may think of it as Pavlovian, classical conditioning) is more compatible with nonmarket theories of friendship. It holds that if you are associated with another person under circumstances of pleasure, regardless of the source of that pleasure, you will like that person.[72] No exchange or payment involved. This theory fits nicely with research on friendship emphasizing the pleasure of joint activities.

Unlike reinforcement theories, social exchange theories of interpersonal relations are deliberately modeled on concepts of economic exchange: They say that all human relations are based on cost-benefit analysis and survive only so long as the benefits exceed the costs. Benefits include sense of power, material rewards, ego enhancements, introductions to important persons, political favors, kindnesses to one's relatives, and so forth. Costs include deference and self-abasement, opportunity costs, sense of obligation, hypocrisy, and similar painful experiences.

Do market societies encourage contingent reinforcement and social exchange behavior to such an extent that they replace the idea that friends are to be intrinsically valued in favor of the view that, like other objects, they have only "exchange value"? Two examples help to illustrate, but not to resolve, the problem. Leonard Berkowitz compared the helping behavior of the children of bureaucrats to that of the children of businessmen. He found that the children of businessmen would help others only in exchange for help to themselves, but that the children of bureaucrats helped others because they thought that was the right thing to do or that helping others represented a general social rule.[73] Here the influence on businessmen's children of market ideology and experience seems to support the development of human relations that are, in essence, exchanges. But in his study of "close friendships," Robert B. Hays found that the best predictor of closeness was not benefits *minus* costs, as exchange theory predicts, but benefits *plus* costs or sacrifices.[74] There is similar folk wisdom: one loves someone whom one has helped. (If, as in utility theory, one wishes to interpret sacrifices as benefits, on the grounds that they produce the benefits of a good conscience, social exchange theory will be as empty as is utility theory.)

I cannot say which model of friendship is more characteristic of advanced market societies. If Hays's subjects, who feel closer to

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those they help, are more characteristic, we might expect that in market societies, there are abundant opportunities for people to counteract social isolation. If, on the other hand, the exchange model in Berkowitz's study is more characteristic, we will not be surprised to find market societies characterized by increasing depression. Michael Argyle writes that "people who simply try to maximize their rewards are liable to lose their friends; socially isolated adolescents have been found to have such childish ideas, and fail to realize that friendship involves loyalty, commitment and concern for the other."[75] In effect, if the contingency reinforcement and social exchange models accurately describe all social relations, including friendships, they prescribe a pattern of human intercourse already characteristic of the disturbed and depressed. No healing benefit comes from "social support"—if that is the term—of this kind.

That the practices and ideology of the market have pervasive effects on people is suggested by the effect that studying market principles has on economics students. Gerald Marwell and Ruth E. Ames gave economics graduate students and others the opportunity to choose either to contribute their earnings to a charitable pot or to keep the money for themselves. The economics students contributed about 20 percent of their earnings to the pot, whereas the others gave from 40 to 60 percent. On examination, the economists had no concepts or vocabulary to define the concept of "public interest."[76] Similarly, Gregory B. Brunk compared the vote intentions of a control group with the intentions of a group of students who had heard a lecture on Downs's theory of "rational ignorance" and the rationality of nonvoting. Those who heard the lecture diminished their intention to vote. Brunk speculated that the current positive effects of education on political participation might come to be reversed, "since those who are better educated will be more likely to encounter theories of rational [non]participation."[77] These examples address the reception of the implied or explicit message: do first whatever directly benefits the self. They do not speak directly to how to regard companionship—but they nevertheless have a message for that domain of life, as well.

The evidence of the rising tide of depression in market democracies, combined with the evidence that depression and unhappiness are caused in substantial part by lack of social support and that many forms of social support, along with the interpersonal trust

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that underlies social support, have declined in the postwar years, indicates that the market, in general, may inhibit friendship. But is there any reason to believe that, in particular, "the rage to consume" has crowded out or otherwise undermined friendship?

III. CONSUMER CULTURE AND FRIENDSHIP

We live in a "consumer culture." One well-known text on consumer behavior imagines Rip Van Winkle's observations on waking from a very long sleep: he would "come to the conclusion that selling, buying, and consuming lie at the very core of life in most of the developed countries of the world."[78] An anthropologist calls this preoccupation a "rage to consume" and attributes it to the synthetic and fallacious "logic of scarcity" of the capitalist system, the "logic" that converts yesterday's concept of plenty into today's scarcity.[79] Calling modern man *Homo consumens*, Erich Fromm claims that "we, as human beings, have no aim except producing and consuming more and more."[80]

Although consumer lifestyles vary by national culture, the emphasis on consumption seems to have affected all advanced economies in much the same way.[81] Perhaps it is a general aspect of modernity. In his studies of the differences between urban, industrial workers and village traditionalists in developing countries, Alex Inkeles developed an index of modernity that included items on "consumer orientation": belief that possessions are the key to happiness, wanting more consumer goods of various kinds, striving to earn in order to possess more consumer goods, and so forth. There was, indeed, a tendency for those whose responses were characteristically "modern," rather than "traditional," to score higher on the consumer orientation items (although these moderns were less likely to think that possessions led to happiness), but the relationship was weak.[82] If there is a "rage to consume," it is more a product of advanced market societies than of modernity in its early stages. Very likely, consumerism is simply a function of disposable income.

The crowding-out hypothesis says that, given limited amounts of time and attention, people must choose between devoting time and attention to friends and devoting them to commodities. For each of these two goods there is a level of supply necessary for

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good health, including mental health, but beyond that level individual choices can mix the two goods in different bundles according to taste. The specific allegation of the crowding-out thesis is that for many people in modern market economies, the hypertrophy of time and attention devoted to commodities has reduced the time and attention devoted to friends below the level necessary for both happiness and mental health.

Were less time devoted to market work,[83] more might be available for either shopping[84] or social activities. Yet might the newly available time be devoted instead to watching television? In order to be sure, we need data on work time, TV-watching time, shopping time, and time spent in socializing with others. I know of only two studies that give these data. The first[85] shows that from 1965 to 1975, when there was a decline in time spent on the job, the newly available time was devoted almost entirely to watching television (men by 35 minutes and women by 47 minutes), but that both men and women decreased their shopping (men much more than women) while they increased the time spent on such activities as visiting, letter writing, and informal social life.[86] The crowding out was mostly done by television, but in the remaining time, socializing increased while shopping decreased.

A second study, using comparable methods but with a better breakdown of activities, covered 1975 to 1981. Although both men and women spent about three times longer watching television than socializing, the time spent on socializing increased slightly, and "the overall impression is that uses of leisure time were slightly more interactive in 1981–82 than in 1975–76."[87] For men the new time released by marginally declining work hours—about one hour per week—was, after a general increase in household work is accounted for, devoted about equally to television, shopping, and socializing. In reverse, the increased time women spent on their jobs came from decreasing housework and from watching less television (about fifty minutes per week), rather than from reductions in social entertainment or conversation.

If attention to commodities were crowding out social interaction, we would expect to find any increase in time spent shopping accompanied by a decrease in socializing. The 1965–1975 study shows just the opposite, while the 1975–1981 study shows relative increases in both shopping and socializing of roughly the same magnitudes. By these (inadequate) tests, the hypothesis that a "rage

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to consume" crowds out socializing fails. If the market has a destructive influence on friendship (and I now think it does), it must be through elevating instrumentalist and materialist values over social values, by eroding communities and neighborhoods, and by intermittently increasing the demand for overtime labor—as in the mid-1990s. In my opinion, a nonmarket influence, watching television, is also responsible for the decline in friendship, but that analysis would take us into new territory.

Shopping as a Social Experience

Has shopping become less of a social experience, more solitary, impersonal, and friendless? The days are long gone by when there were counter-clerks instead of checkers-out, when a neighborhood store was a social center and the storekeeper was everyone's friend. Can this change in the human relations of shopping serve to increase the sense of isolation experienced by depressives?

Before accepting this hypothesis, we must note that many companies are sensitive to the demand for "friendliness" and train their staffs to offer it: "the 'friendliness' of their staff may be crucial for airlines, hotel chains, or fast food outlets in establishing a market identity."[88] While a benefit to customers, "friendliness" does not lead to friendship or to the recruitment of the confidants so desperately needed by depressives.

There is, however, another dimension to shopping as a social experience: shopping with a member of the family. Some families make of shopping an intrinsically rewarding family experience.[89] A "family gatekeeper" (a psychographic marketing category) revealed a source of pleasure in her role as an opinion leader: "People come to me more often than I go to them for information on brands." As a way of keeping her store of information up to date, she says "I shop a lot for specials."[90] Because it takes time to shop for specials and to do comparative shopping, working-class shoppers rely more on advice from family and friends, familiar stores, and what is called "face-to-face" shopping. In the working class, too, husband-and-wife shopping teams are more common,[91] and perhaps the increased time devoted to shopping by husbands in all social classes has increased this shared experience.

Yet the demise of the neighborhood store, the colder relations

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between shopkeepers and their clients, and the modesty of the growth of husband-wife shopping all suggest an increasingly unsociable climate for consumers. Shopping is still divided along lines of gender, women doing most of the everyday shopping and men doing most of the shopping for consumer durables. Economic theories basing the division of domestic labor on relative market earning power and relative skills largely fail in the face of the overwhelmingly more important ideology of traditional sex roles.[92] Since the growth of impersonality in patron-client relations fails to find compensation in social shopping, the hypothesis claiming a colder shopping experience is tentatively supported.

Consumption as a Social Experience

The tentative hypothesis in this section is that there has been a shift from collective to individual consumption, with a consequent loss of social interaction. It has been alleged that "the number of products that an individual always buys for individual consumption must certainly represent a very small proportion of consumer expenditures." Spending money on collectively consumed goods requires exstensive family discussion.[93] Beyond the family, people talk about their various consumption experiences. Elihu Katz and Paul Lazarsfeld's early analysis of "opinion leaders" found that women talked much more—and much more democratically—about articles of purchase than about politics. In discussing politics, there was a certain deference to the wife of someone who might be expected to be informed, but regarding commodities, everyone was her own expert.[94]

A variety of goods may invite or require social participation for their enjoyment: food and drink, playing baseball and playing cards, bingo and bowling, attending sporting events, theater, and concerts. In each case the enjoyment of others is almost a condition for enjoyment by the self. The idea that consumption is primarily a solipsistic experience, where only one's own utilities count, and not a collective experience dependent on the utilities of others, could only be entertained by economists. Even taken singly, a large part of the pleasures of consumption are social.[95]

Is consumption more or less social than it once was? I suggest the following proposition: *beyond a certain level of income, increased dispos-*

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able income is more likely to be spent on goods consumed individually than on goods consumed collectively by households. The marked increase in disposable income in the 1960s coincided with decreased happiness, but this could well be because of unpleasant political developments such as the Vietnam War and urban riots. Whatever the causes, along with the rise in per capita income came the beginning of the wave of depression that now plagues all advanced economies. From the gross data it is not easy to know exactly how the greater disposable income was consumed, but we know that the proportion of income spent on food, which is often consumed in groups, and on housing declines as income rises. And there are suggestive items in recent accounts of household budgets: between 1985 and 1988, household expenditures for food and housing increased about 2 percent while expenditures for "personal care" increased about 6 percent. (Time spent on personal care also increased in recent years.)[96] Similarly, between 1988 and 1989 the expenditures for food, housing, and household operations and furnishings each increased by less than 4 percent, while expenditures on the more individualized items in "apparel and services" increased 7.4 percent.[97]

To make the point more vivid, consider how the category of things associated with "home," e.g., the house itself and certain familiar rooms, is uniquely capable of enhancing a sense of well-being, especially among children. These things are often cherished and are four times as likely to be positively than negatively "toned," a higher positive loading than any other set of objects.[98] Family objects also have evocative power, as Peter Laslett observes in *The World We Have Lost*: "Time was when the whole of life went forward in the family, in a circle of loved, familiar faces, known and fondled objects, all to human size. That time has gone for ever. It makes us very different from our ancestors."[99] Does it also make us more depressed?

In the welter of alleged causes for the loss of social support and friendship that is surely a prime contributor to the upsurge in depression, I have found some ambiguous evidence that markets, themselves, are an inherent cause of social isolation; I have questioned the idea that attention to buying and consuming necessarily crowd out the time and attention available for friendship, suggesting instead that television may have this isolating effect; and I have proposed that the increased impersonality of shopping and the increased use of individually, as contrasted to socially, consumed

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goods have played modest roles in the loss of a therapeutic community of friends.

IV. THE MOTIVE TO AFFILIATE VS. THE DEMAND FOR GOODS

In this section I will compare two motives: affiliative and materialistic. Although the general need for affiliation with members of our species is universal[100] and the absence of affiliation has been shown to make people unhappy and invite depression, it does not follow that in the United States (or elsewhere) there is a demand for more friends than people have now, since people may not be aware of their affiliative needs. The degree of conscious loneliness is a kind of test of the demand for affiliation.

A survey conducted in the early 1970s found very little loneliness: asked to rate their lives on ten dimensions ("boring—interesting," "hard—easy," "lonely—friendly," etc.), the people rated the friendliness of their lives second highest.[101] Urbanism is said to increase loneliness, but a study of the variation in interpersonal relations by size of community found that "total isolation is only weakly, if at all, associated with urbanism."[102] (However, in cities the networks that take the place of neighborhoods favor the more mobile middle class. And rural places can be very lonely.)

Because of the social stigma of loneliness,[103] however, we cannot wholly trust self-reports. A little specific probing finds a higher number of lonely people,[104] and the in-depth reports of depressives in urban settings locate even more, although even among these people loneliness was consciously experienced as such only when someone they cherished left the home or neighborhood.[105]

Although the early-1970s survey found that those with the most friends were the most satisfied with their lives and that a large majority expressed *some* desire to make new friends, the urgency of this desire was minimal: only one half of one percent said they were "very interested." As might be expected, those who had the fewest friends were the most likely to be "very interested," although those with the most friends were the most likely to show a modest interest in making new friends.[106] This pattern suggests the causal influence of personality, and, indeed, extroversion has been found to be both directly associated with general cheerfulness and pro-

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ductive of friendships that add to a person's happiness.[107] It is the introverted, the socially awkward, and those for whom friendship is a problem who would benefit from any institutional or cultural pattern that changes priorities among commodities and friends.

Whatever else may be said about the popular demand for friendship, it does not represent a "rage" for affiliation. Taking a cue from the studies of depression, we might suspect that the *idea* of new friends is generally attractive, but that loneliness, the conscious feeling of a lack of friends, and an urgent desire to make new ones come when some person one counted as a friend leaves, quarrels, or dies (although grief is rarely, by itself, a cause of depression). In this sense, although it is well established that having a lot of friends contributes to a sense of well-being, *demand* for new friendships more closely resembles the demand for replacing a car or a refrigerator that collapses than the more "elastic" demand for other commodities.

Although materialist motives may be assumed by economists, they have been largely ignored by psychologists (or, as mentioned above, have been treated as compensatory for deficient social relations), possibly because they defy assessment in the same terms as the "need for affiliation." The *demand* for material goods, however, is apparent. On average, almost regardless of their current levels of income, people believe they would, finally, be happy with only 25 percent more income. But of course the fact that the same estimate is made by those who already have 25 percent more suggests its foolhardiness. Similarly, when asked to rate the desirable and undesirable characteristics of their jobs, people rank congenial workmates at the same level as pay (and interesting work ahead of both). Yet the demand for jobs is more influenced by financial rewards than by anticipated social rewards, albeit partly because applicants know more about pay levels than friendship levels.[108]

Economists, believing that "needs" are inherently subjective and that only "revealed preferences" are real, are satisfied only with the evidence provided by actual choices. By these standards it may seem that the demand for income with which to buy goods and services is greater than the demand for more friends. But this is not quite right: the way people have used the new leisure time generated by (somewhat) shorter working hours since World War II "reveals" a demand for more television, not more income or commodities—even though people rank watching television sev-

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enteenth in importance among twenty-eight activities listed, much lower than their work, which, in turn, is ranked lower than various socializing activities;[109] thus, as introspection tends to confirm, people spend hours watching programs they do not care for.

Revealed preferences favor marginal increments of wealth over increments of affiliation. But revealed preferences have very little to do with happiness, and even less with protection against depression.

V. THE ROAD NOT TAKEN: GIVING FRIENDSHIP PRIORITY OVER COMMODITIES

The evidence on the rising incidence of depression in advanced economies seems to confirm the belief that market solutions to the deficit of companionship in modern society have failed. Economic growth is unlikely to be a solution, since precisely those countries that have experienced or are currently experiencing rapid economic growth have the highest incidence of depression.

Democracy's solution to distress, the welfare state, has, at least in this respect, failed as well. Those financially dependent on public aid are three times more likely than similar others to be depressed.[110] Although the causal relationship between being a welfare client and being depressed is not clear, no one has suggested that welfare is a solution to friendlessness, for unemployment and welfare are known to be socially isolating experiences. (The contribution to family felicity of government pensions for aged parents is another matter.)

If we were to follow the indications of widespread need, rather than of demand, how would we give priority to the pursuit of friendship (and family solidarity) over the pursuit of commodities? The basic idea would be for governments and markets (that is to say, firms) to make the loss of such companionship and family solidarity a cost, and the gain of these things a benefit, in their respective calculations. But people are chary of governmental intrusion in their most private lives. Therefore, lest governments become invasive and paternalistic, the authorities would have to focus on creating a "scaffolding" within which individuals would find new opportunities for the companionship and family solidarity that would genuinely increase their sense of well-being. And,

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since the market is responsive entirely to prices and the opportunities for monetary profit, governments would have to alter firms' cost and profit calculations so that they would themselves seek to foster companionship (if not workmen's solidarity!) and reciprocal affection in family life.

In conclusion, let us consider a possible individualistic solution to depression and boon to happiness that does not depend on greater friendship.

An Alternative Source of Happiness

Given the crucial contribution to well-being made by social support in general and by friendship in particular, social support seems almost (but not quite) to be a sufficient condition for the happy life. But is it also a necessary condition? Solitary and possibly quite happy academics, professionals, artists, and artisans who find their satisfaction in work, without benefit of affiliation, will be right to doubt the necessity of more extensive friendships.

In an important, somewhat neglected study of well-being, Antonia Abbey and Frank M. Andrews stumbled on findings that illuminate these common-sense observations. They found, as have others, that "performance" (a feeling of having done a task well), social support, and a sense of controlling one's own fate were the major positive sources of well-being. But they also found that the last two, social support and sense of control, were substitutes for each other. That is, if a person has a high sense of control over her life, social support adds nothing to her well-being, while if a person has a high sense of social support, it does not matter if he has a sense of personal control. "Experiencing high levels of both social support and internal control seems to be no more beneficial than experiencing high levels of either one alone."[111] This important finding is supported by a more recent study showing that "control and support can substitute for one another to decrease depression."[112] Because a sense of personal control is closely related to happiness and is a specific antidote to that helplessness associated with depression, it may be a much more individualistic possible therapy for the malaise of modern societies.

But any policy that depended on developing in the population at large, and especially among those individuals who are more vul-

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nerable to depression, the sense that they control their own destinies, particularly in a society where this is only marginally true, is unlikely to achieve its end. We follow the course laid down by the biological nature of a social species only if we seek to cultivate the bonding instincts with which we are born.[113]

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49. Rena L. Repetti, "Individual and Common Components of the Social Environment at Work and Psychological Well-Being," *Journal of Personality and Social Psychology* 52 (1987): 710–20.
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55. Campbell (n35 above), 56–58.
56. Morris Rosenberg and Roberta G. Simmons, *Black and White Self-Esteem: The Urban School Child* (Washington, D.C.: American Sociological Association, 1971).
57. Richard Koestner, Miron Zuckerman, and Julia Koestner, "Praise, Involvement, and Intrinsic Motivation," *Journal of Personality and Social Psychology* 52 (1987): 383–90. But girls are more suspicious of praise than boys.
58. Lane, *The Market Experience* (n36 above), ch. 27, "Misunderstanding Happiness"; Richard Nisbett and Lee Ross, *Human Inference: Strategies and Shortcomings of Social Judgment* (Englewood Cliffs, N.J.: Prentice-Hall, 1980), ch. 9.
59. Roy Harrod, *Sociology, Morals and Mystery* (London: Macmillan, 1971), 64.
60. Lane, *The Market Experience* (n36 above), 555–56.
61. Daryl J. Bem, "Self-Perception Theory," in Leonard Berkowitz, ed., *Advances in Experimental Social Psychology*, vol. 6 (New York: Academic Press, 1972).
62. Georg Simmel, "The Metropolis and Mental Life," in *The Sociology of Georg Simmel*, trans. & ed. Kurt H. Wolff (Glencoe, Ill.: Free Press, 1950), 412.
63. Robert E. Lane, "Interpersonal Relations and Leadership in a 'Cold Society,'" *Comparative Politics* 10 (1978): 443–59. The arguments given in the text below are summarized in idem, *The Market Experience* (n36 above), 215–19. In addition, the interchangeability of commodities and friends violates the preference of exchanging like-for-like goods demonstrated in Uriel Foa, "Interpersonal and Economic Resources," *Science* 171 (29 January 1971): 345–51. Taboos against money gifts to family members are illustrative of the compartmentalization of exchange.
64. Allen Silver, "Friendship in Commercial Society: Eighteenth-Century Social Theory and Modern Sociology," *American Journal of Sociology* 95 (1990): 1474–1504 at 1474.
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70. George Homans, *Social Behavior: Its Elementary Forms* (New York: Harcourt, Brace & World, 1961); Peter M. Blau, *Exchange and Power in Social Life* (New York: Wiley, 1964).
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72. Albert J. Lott and Bernice E. Lott, "The Role of Reward in the Formation of Positive Interpersonal Attitudes," in Huston, ed. (n71 above), 171–92.
73. Leonard Berkowitz and Philip Friedman, "Some Social Class Differences in Helping Behavior," *Journal of Personality and Social Psychology* 5 (1967): 217–25.
74. Robert B. Hays, "A Longitudinal Study of Friendship Development," *Journal of Personality and Social Psychology* 48 (1985): 909–24.
75. Argyle (n41 above), 66, citing J. J. La Gaipa and H.D. Wood, "Friendship in Disturbed Adolescents," in S. Duck and R. Gilmour, eds., *Personal Relationships*, vol. 3, *Personal Relationships in Disorder* (London: Academic Press, 1981).
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78. James F. Engel, Roger D. Blackwell, and David T. Kollat, *Consumer Behavior*, 3rd ed. (Hinsdale, Ill.: Dryden Press, 1978), 3.
79. Stanley Diamond, *In Search of the Primitive* (New Brunswick, N.J.: Transaction, 1974), 11.
80. Erich Fromm, *The Revolution of Hope* (New York: Rinehart, 1968), 1, 28. Along lines similar to mine, Fromm then advises a more "humanistic" form of consumption (120). For a rejoinder to this and other criticisms of consumption, see George Katona, *Psychological Economics* (New York: Elsevier, 1975), 376.
81. Susanne C. Grunert and Gerhard Scherhorn, "Consumer Values in West Germany: Underlying Dimensions and Cross-cultural Comparison with North America," *Journal of Business Research* 20 (March 1990): 97–107.
82. Alex Inkeles and David H. Smith, *Becoming Modern* (Cambridge, Mass.: Harvard University Press, 1974), 97, 349.

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83. Is this hypothesis untestable, because Americans have, over the last twenty years, increased the amount of time they spend working, as Juliet Schor claims in *The Overworked American: The Unexpected Decline of Leisure* (New York: Basic Books, 1991)? No, because the evidence for an increase in working time over twenty years is at best ambiguous. In gross terms, the average weekly period of nonagricultural employment from age 16 to age 64 has gone from 38.3 hours in 1970, to 38.1 hours in 1975, to 38.7 in 1985, to 39.1 in 1988. By international standards the latter figure hardly represents "overwork." While it seems to be true that women, with their dual responsibilities, are "overworked," among men only the better educated are, as of 1994, working longer than they were twenty years ago, while those with only high school or less education are working fewer hours now than in 1975. 1981–82 data show that if one adds household work to market work, men in the 25–44 age group worked 61.4 hours, while women in the same age group worked 56.4 hours. But it is certainly true that Americans have shorter vacations and fewer holidays than Europeans. See Sylvia Nasar, "More Men in Prime of Life Spend Less Time Working," *New York Times,* December 1, 1994: A1, D15; F. Thomas Juster, "A Note on Recent Changes in Time Use," ch. 12 in F. Thomas Juster and Frank P. Stafford, eds., *Time, Goods, and Well-Being* (Ann Arbor, Mich.: Institute for Social Research, 1986), 318–19; and U.S. Bureau of the Census, *Statistical Abstract of the United States: 1980,* 394, and *1990,* 386, 379 (Washington, D.C.: G.P.O.).
84. While it might be objected that income, rather than the availability of time, determines how much time one shops, the fact is that nationally, time spent shopping has *declined* as per capita income has increased; and, in any event, time spent shopping is unrelated to level of income.
85. Robinson, "Changes in Time Use: An Historical Overview," in Juster and Stafford (n83 above).
86. Ibid., 305. While such gross figures are important, a more careful analysis would break down the figures by social group. E.g., for the 1975–1981 comparison, elderly men increased their television watching by 8 hours and decreased their "services, shopping" by half an hour, whereas young husbands did not increase their television watching at all and *increased* their shopping by about half an hour.
87. F. Thomas Juster, "A Note on Recent Changes in Time Use," ch. 12 in Juster and Stafford (n83 above), 318–19. There was a modest decline in television exposure in the U.S. during the 1975–1982 period, mostly among young adults and more often among men than women. There was also a British decline, with an estimated average exposure of 27.1 minutes per day in 1985 declining to 25.1 minutes in 1990 (*The Independent,* 25 June 1992: 3).
88. Keith Dowding and Patrick Dunleavy, "Production, Disbursement and Consumption: The Modes and Modalities of Goods and Services," paper presented to the University of Salford (U.K.) conference on "The Marketization of Consumption: Public and Private," 8 July 1994: 3.

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89. Engel et al. (n78 above), 12–13.
90. Joseph Plummer, "Applications of Life Style Research in the Creation of Advertising Campaigns," in William D. Wells, ed., *Life Style & Psychographics* (Chicago: American Marketing Association, 1974), 166.
91. Engel et al., 135–36.
92. Martha S. Hill and F. Thomas Juster, "Constraints and Complementarities in Time Use," ch. 18 of Juster and Stafford (n83 above), 461. It should be noted that Hill and Juster believe that the force of gender roles found in their study is changing, but that the current pattern still reflects a division between the sexes. Married women who work for wages average between 3 and 18 more hours per week in total work than do married men. (Hill, 147.) And women with jobs spend almost as much time shopping as do housewives. It is this dual role that creates strains leading to distress (Barbara Wolfe and Robert Haveman, "Time Allocation, Market Work, and Change in Female Health," *American Economic Review: Papers and Proceedings of the Ninety-Fifth Annual Meetings of the American Economic Association* 73 [1983]: 134–39).
93. Hill, 151–52, 160–61.
94. Elihu Katz and Paul Felix Lazarsfeld, *Personal Influence: The Part Played by People in the Flow of Mass Communications* (Glencoe, Ill.: Free Press, 1955).
95. There is a large literature on "collective consumption" which I cannot discuss here. This literature deals in part with the public-private dimension and the government regulation of consumption, but not, I think, with the way collective consumption encourages companionship. I am greatly indebted to Dowding and Dunleavy (n88 above). See also Patrick Dunleavy, *Democracy, Bureaucracy, and Public Choice* (Englewood Cliffs, N.J.: Prentice-Hall, 1992).
96. Robinson (n85 above), 299.
97. U.S. Bureau of the Census, *Statistical Abstract of the United States, 1990* (Washington, D.C. G.P.O., 1990), Tables 699 and 713. Comparisons for earlier periods do not always confirm the thesis advanced.
98. Mihalyi Csikszentmihalyi and Eugene Rochberg-Halton, *The Meaning of Things: Domestic Symbols and the Self* (Cambridge: Cambridge University Press, 1981), 129.
99. Peter Laslett, *The World We Have Lost*, 2nd ed. (New York: Scribner's, 1971), 22.
100. See John Bowlby, *Attachment and Loss*, vol. I, *Attachment* (New York: Basic Books, 1969); Steve Duck, *Understanding Relationships* (New York: Guilford Press, 1991); David C. McClelland, *Human Motivation* (Glenview, Ill.: Scott, Foresman, 1985). McClelland explores the need for affiliation along with both the fear of rejection *and* the fear of intimacy.
101. Campbell et al. (n28 above), 48. See also Peter K. Lunt, "The Perceived Causal Structure of Loneliness," *Journal of Personality and Social Psychology* 61 (1991): 26–33.
102. Claude S. Fischer, "On Urban Alienation and Anomie, Powerlessness and Social Isolation," *American Sociological Review* 38 (June 1973): 311–26 at 323.

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103. S. Lau and Gerald E. Gruen, "The Social Stigma of Loneliness: Effect of Target Person's and Perceiver's Sex," *Personality and Social Psychology Bulletin* 18 (1992): 182–89.
104. Lunt (n101 above), 26–33.
105. Brown and Harris (n26 above), 133.
106. Campbell et al. (n28 above), 358–50, 380.
107. Michael Argyle and Maryanne Martin, "The Psychological Causes of Happiness," in Fritz Strack, Michael Argyle, and Norbert Schwarz, eds., *Subjective Well-Being: An Interdisciplinary Perspective* (Oxford: Pergamon, 1991).
108. Robert P. Quinn and Linda J. Shepard, *The 1972–73 Quality of Employment Survey* (Ann Arbor: Institute of Social Research), 1074, Table 3.28. See also Christopher Jencks, Lauri Perman, and Lee Rainwater, "What Is a Good Job? A New Measure of Labor-Market Success," *American Journal of Sociology* 93 (1988): 1322–57.
109. Juster (n87 above), 335.
110. Weissman et al. (n6 above), 76.
111. Abbey and Andrews (n15 above), 108.
112. Catherine E. Ross and John Mirowsky, "Explaining the Social Patterns of Depression: Control and Problem Solving or Support and Talking?" *Journal of Health & Social Behavior* 39 (June 1989): 206–219 at 206.
113. Edward O. Wilson, *Sociobiology: The New Synthesis* (Cambridge, Mass.: Harvard University Press, 1975). Wilson (7) gives the following example of the affiliative instincts of our primate forebears: "Rhesus monkeys, like other higher primates, are intensely affected by their [social] environments—an isolated individual will repeatedly pull a lever with no reward other than the glimpse of another monkey." But there is evidence that controlling one's environment, too, is a motive with biological roots: like affiliative motives, the need for control seems to be present in more than one species.

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James Q. Wilson

WEALTH AND HAPPINESS

In The Market Experience, *Robert Lane restates the central criticism of economic views of human satisfaction—namely, that they define welfare as utility and, in practice if not in theory, use money as the measure of utility, while in reality utility (or welfare) ought to be defined as happiness. In exploring the implications of this noneconomic definition for our assessment of markets, Lane summarizes the evidence about how people assess their own happiness more successfully than he clarifies the meaning of that word. Since increases in income above a certain minimum do not increase happiness, work must be made more meaningful.*

Robert E. Lane's *The Market Experience* (Cambridge: Cambridge University Press, 1991) states its central premise with admirable clarity: "The market should be judged by the satisfactions people receive as a consequence of their market experiences and by what they learn from them." At first blush this criterion may seem similar to the conventional standard for judging any economic arrangement, namely, its capacity to maximize consumer welfare. But as Lane notes, the similarity is more apparent than real, for the economists' standard turns out to be efficiency in production and, to a lesser degree, equity in distribution. Now, this interpretation of the goal of maximizing consumer welfare is not objectionable so long as "welfare" is understood to mean "utility," largely measured by

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money income or material satisfactions. But Lane immediately reminds us of what many others have already pointed out: whereas "utility" can mean anything, and indeed represents a notion (as Joan Robinson put it) or impregnable circularity, economists ordinarily define it in monetary terms. Moreover, utility—the bundle of wants that markets satisfy—is taken as given and essentially unchanged. In fact wants are various, often nonmaterial in nature, and subject to change.

So far all of this is part of the standard critique of modern economic theory, a critique most economists acknowledge as correct but not highly relevant. They respond by arguing that though money is not identical to utility or welfare it is usually a precondition for these more complex goods. Even Mother Teresa needs money with which to help the suffering poor in Calcutta. So many people, ranging from the Salvation Army to the Mafia, want money for so many purposes that, even if it is not equivalent to utility or welfare, it is a suitable measure of whatever it is that people really do want. The task that Lane sets himself is to supply a better standard by which to judge markets and people's experience in them.

In carrying out this task, he carefully avoids enlisting in the ranks of either the traditional humanist or conventional socialist critiques of markets. He is not Thomas Carlyle, John Ruskin, E. F. Schumacher, E. J. Mishan, nor is he Marx or Engels. Unlike many humanists, Lane does not believe that markets (compared to other economic arrangements) weaken human character, make people more selfish or materialistic, or corrupt their ethical judgment. Whatever the moral consequence of markets (Adam Smith pointed many out, two centuries ago), the effects on people of command economies are far worse—hoarding, corruption, and poverty. Unlike many socialists, he doubts that any redistribution of income will result in an equivalent (if any) redistribution of happiness. Above a certain level, having more money does not seem to lead to more happiness, and the process of redistribution itself can lead to the very class hatreds and interpersonal envy that it is intended to eliminate.

At this point the book loses the clarity with which it began. What ensues is six hundred pages of increasingly complex, ponderous, and sometimes jargon-ridden prose[1] that grapples with the core question: if not utility, defined loosely as money, what? Or to be exact, what constitutes human well-being and how can we

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estimate the extent to which markets (or any other social arrangements) produce it? By the time he turns to the question of reforming economic institutions to make them more productive of human well-being rightly understood, he seems to have nothing to say beyond urging us to "change the axis of debate in political economy." In order to meet "the challenge of axial rotation" we must prefer "producer values" over "consumer values." By this he means valuing work itself and, since jobs differ in their capacity to create a sense of well-being and personal development, redistributing it. The process of production—work itself—is "the key to happiness and development." Assuming for the moment that this assertion is true, how are we to take advantage of it? Beyond more statements about "axial rotations," we are told next to nothing. The last two sentences in the book inform us that we must first discover how to make markets better, a task that for Lane has "only just begun."

There is nothing wrong with writing a book that analyzes a problem without offering a solution to it, provided the analysis so clarifies the problem that each person reading it can begin to form his or her own judgments. But Lane has not really clarified the problem so much as he has pointed at it. Had he clarified it, he would have specified what we mean by happiness and explained carefully to us in what ways markets fail to enhance happiness compared to some other feasible alternative.

He makes several passes at doing just that, all displaying high intelligence and wide reading, but none of his efforts to define happiness or explain its source quite come off. Let me begin with the first attempt at a definition on pages 9 through 11. There are two maximands, he writes: subjective well-being and human development. The first has two components, happiness and satisfaction with life as a whole. Happiness "is defined as a more or less enduring and comprehensive emotional state." Life satisfaction is a "cognitive appraisal of one's life." Neither can be achieved by "summing local utilities."

Human development has three parts: cognitive complexity, self-attribution, and self-esteem. The first, cognitive complexity, involves the ability to employ concepts systematically, test them against experience, think at abstract levels, integrate stimuli, and view things more or less objectively. The second, self-attribution, means a sense of personal efficacy. The third, self-esteem, refers, not to pride, but to the belief that one is deserving of respect.

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These initial definitions are, to put it mildly, a bit vague. "Happiness" is not given anything even remotely like a definition. There are many "enduring emotional states" (for example, the frustration often attendant upon reading Lane's book) that no one would call happy in any meaningful sense of the word. Now I grant that even the greatest philosophers have had little success in providing an unambiguous definition of happiness; indeed, Socrates suggested that only those who had experienced the greatest happiness (wisdom, for example) could even understand that other forms (bodily pleasure, for example) were in fact lesser forms, and therefore not true happiness at all. I don't wish to hold Lane to a higher philosophical standard. But what is at issue in this book is not philosophy but markets, and, in particular, the usefulness of money income ("utility," as practically defined) as a measure of market outcomes. If we are searching for a way of evaluating markets that is superior to the economists' method—that is, a way that is better than money—then any ambiguity in the definition is not simply a philosophical inevitability but a scientific defect.

Even if this difficulty is surmounted, at least two others remain. For markets to be judged against the two components of well-being and the several components of human development, some principle of making and evaluating trade-offs among these criteria must be established. One can imagine a person saying that he feels happy in the sense of liking his wife and children and his job but unhappy in the sense of not having brought under control his diabetes or earning enough money to have a nice vacation. What is his net level of happiness? It is, I suppose, what he says it is, but what he says it is will depend a lot on whether he is asked when his disease is acting up or his children are having a tantrum or he and his wife have just enjoyed a pleasant day at the beach. Or he may like the fact that he is "developed" enough to do well on crossword puzzles but dislike the fact that he feels he has no say over political affairs.

Moreover, some aspects of human development are not susceptible to change, whatever one's position in the market. "Cognitive complexity" tends to be an innate trait that cannot be much modified by experience; Lane's definition of it is a rough approximation of what psychometricians mean when they refer to intelligence, or at least to the general factor—*g*—in intelligence. How can the mar-

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ket be evaluated by the standard of cognitive complexity if the market cannot much affect that attribute?

These issues will trouble the reader through most of the book, but toward the end, Lane returns to these issues from a different and possibly more helpful perspective. He observes that, however great the issues of definition, priority, and malleability, people still manage to tell other people whether they are or are not happy, and these reports are meaningful. He is right, of course. Indeed, the most interesting parts of this book are the sections in which he reports the findings of scholars who have asked just such questions. To me, the heart of the book is to be found in Part VII, where these empirical studies are summarized.

By attaching significance to these findings, Lane is attacking one of the most cherished yet least plausible principles of economics, namely, that there can be no meaningful interpersonal comparison of utilities. When one thinks about it, it is really quite astonishing that some scholars have acted as if no one can know anything about how anyone other than oneself feels about life. It is obvious that most people spend a lot of time worrying about whether their spouses or their children or their friends are happy, comparing their happiness today with their happiness yesterday, and devising ways of making them happier in the future. And it is necessary that they make these comparisons inasmuch as their own sense of well-being is often affected by the well-being of others (in other words, utilities are interdependent).

But having returned to the core issues, Lane still cannot seem to state his criteria with much clarity. On two maddeningly opaque pages (447 and 448) he claims to set forth the difference between happiness and satisfaction. I am not certain that I understand exactly what he means, but it seems to be something like this: There are two standards of human well-being: satisfaction and happiness. The former is tapped by asking people how satisfied they are with life these days, the latter by asking them how happy they are. Fine, they are tapped that way, but what, theoretically, do these words mean? From what I can gather, satisfaction refers to an assessment of one's life taken as a whole, netting out the good and the bad. Happiness refers to a mood at the moment. (But earlier Lane told us that happiness referred to an enduring emotional state. Has something changed?)

The empirical studies on which Lane relies make use of these

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terms, but it is not clear that the authors of these studies mean by them what Lane means. For example, Angus Campbell and his co-workers found that young people tend to be happier but less satisfied than older people. Having fun and enjoying your friends may lead to happiness despite the fact that one has yet to settle on a career or put down any roots; by contrast, one can be satisfied with the life one has led and the accomplishments one has made despite the fact that owing to ill-health or advanced age one is not as happy as one might like. Happiness is more of an emotion, satisfaction more of a cognition. Let me confess that I am not certain this is what Lane intends us to think. The uncertainty engendered by his expository style is a major problem, *given the goal of the book*—namely, to provide an alternative way of assessing markets.

The authors of studies like that of Campbell, et al., ask people how they feel about their lives as a whole, as well as about several particular domains of life (work, family, friends, leisure, and so forth). In general, these studies seem to agree that the satisfaction people evince about life as a whole depends mainly on how satisfied they are with their families; by contrast, the state of their health or their views about government make almost no difference. And, crucial to Lane's argument, above some minimum level, how large an income people have is a poor predictor of happiness; by contrast, how satisfied they are with their jobs is such a predictor.

The elements of satisfaction are additive—people who are happy with friends, family, and work are more satisfied with their lives than are people who are happy only about their friends. But there is no hierarchy of psychological needs evident in these findings; contrary to what Abraham Maslow predicted, it is not necessary to be satisfied with certain more elemental conditions of life before one can find happiness in higher levels.

Lane draws two large implications from these studies. The first is that, above a certain minimum, more money does not buy more happiness. The second is that for most people, work is not simply or even mainly a burden or a cost, it is a source of satisfaction (or happiness). Around the world, very poor people are unhappy in large measure because they have so little money, but beyond that, money is not associated with happiness: the rich seem no happier than the middle-class, and the latter no more satisfied than blue-collar workers. We have always known that commodities (and probably money) have a diminishing marginal value, but Lane is

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saying something more than that; he is suggesting that even the average dollar is not associated (above some minimum) with happiness.

Similarly with occupational status: there seems to be little correlation between the prestige of one's job and the satisfaction one derives from it. Stressed-out physicians may be no happier than less well-paid and lower-status electricians. That work is often a source of satisfaction, rather than simply a burden we endure for the sake of a money income, should be evident to anybody who knows a retired person who cannot relax and enjoy his assured income; instead, he has to "find something to do," which often means finding a job, even one that pays poorly or not at all.

Lane reviews a number of studies that suggest that there is a correlation between the kind of work one does and the quality of one's life. These studies suggest, but certainly do not prove, that, for example, having a "self-directed" or cognitively complex job will improve one's personality, enhance intellectual growth, and broaden understanding. Work is not only a source of well-being, it can be a source of human development.

These findings, most of which I find plausible and consonant with everyday experience, leave some obvious questions unanswered. If more money does not buy more happiness, why do people strive relentlessly for more money? Apparently because it buys something they value. But if they value it, why does it not lead to an increase in happiness? Are people fools, trapped like rats on a hedonic treadmill, pursuing the next increment of reward only to discover its illusory value?

I think not. People value money for exactly the reasons economists say they do—because it is a means of commanding resources. There are, of course, things that money can't buy—love, for example—but money can increase the chances of finding even those ineffable things. For example, women evaluate men as potential husbands in no small measure by their apparent wealth or capacity to acquire wealth. Men who convey better financial prospects have a wider choice of prospective wives.[2] Married couples often quarrel about money, or the lack thereof. Parents cannot buy good children, but they can and do buy better schools for their children and better neighborhoods in which to raise them, and they hope that having provided those things, the children will be better

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(and happier) for it, and they will be happier from contemplating their children's happiness.

The cross-sectional surveys on which Lane relies cannot really address these matters because, with one or two exceptions, they do not, insofar as I am aware, provide any frame of reference within which to judge happiness or measure changes in life satisfaction that come, or fail to come, from moving from one economic circumstance to another. Suppose that a middle-class, middle-aged college professor tells an interviewer that she is happy or satisfied with her life. What does she mean? Is she happy compared to how she once felt when, as a graduate student, she looked forward apprehensively to the long struggle to earn a degree, find a job, and win tenure? Or is she happy now in comparison with her friends who, forsaking careers, got married and had babies? Or perhaps she is happy in some absolute sense because she is temperamentally sanguine, able to make the best of whatever life produces.

Lane reports at least one study that discusses happiness and satisfaction with one's life following a change in income (533). He notes that small gains in income produce little, if any, increase in satisfaction with "life as a whole," but big increases in happiness, and that even small losses of income are associated with being less satisfied and less happy. This study seems to me to cast some doubt on the argument that money makes little difference in satisfaction or happiness, but Lane does not explicitly reconcile this finding with his general argument.

There will be little or no relationship between income or status on the one hand and happiness or life satisfaction on the other in either of two circumstances. If happiness is a trait that is more or less fixed by biological endowment and early childhood experiences, then absent great extremes of deprivation or disease, happiness will remain constant. If happiness is a sense of relative benefit derived from comparing yourself to others similarly situated, then happiness will not vary as your status varies because you will change the group against which you compare yourself. (Lane mentions these possibilities, but I find his discussion of them inconclusive.)

If happiness is a trait, why should it be correlated with family life and other such nonmarket circumstances? I do not know, but it may be that happy people are more likely than unhappy ones to contract good marriages, raise agreeable children, attract amiable

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friends, enjoy leisure activities, and find satisfaction in their work. Happiness may *cause* these outcomes, and not the other way around. Happiness as a trait may have less to do, however, with producing a higher income, since income will reflect, among other things, talents, interests, and luck.

In sum: I think that Lane is certainly correct to fault economists for neglecting the positive value of many kinds of work. He may be correct to say that more money does not buy greater satisfaction or happiness, but he has not clarified these terms with sufficient care or produced sufficient evidence to convince me that he has made a strong case. He has acknowledged the possibility that happiness may be a trait with a strong biological (that is, hereditary) component, but he has not systematically related this possibility to his argument that certain kinds of work expand the mind and ennoble the soul.

The book, as I have noted, tells us rather little about what Lane would have us do with all of the possibilities he has raised. Some clues as to his views, however, can be gleaned from an essay he published not long after his book appeared.[3] There he suggested the following: Economic growth is desirable because it will help the poor (for them, getting more money is a prerequisite to greater happiness), and it may help some among the more affluent (if it places them in "self-directed" jobs and equips them with "postmaterialist" values). And since, he claims, certain kinds of work improve people, it ought to be the task of government to emphasize full employment over increases in per-capita income, to reward firms that "up-skill" their jobs, and to "intervene" in unspecified ways to deal with market forces that preserve low-skilled jobs.

I applaud Lane's recognition of economic growth (though he understates, in my view, its value) and his lack of interest in income redistribution as a way of achieving greater human well-being. His criticisms of the market as the sovereign guide to human happiness are often well-taken, but they are really aimed, not at actual markets, but at the doctrine of markets that some economists have erected. (He rightly notes that Adam Smith never claimed that markets would produce happiness; in fact, he thought they might lead to a variety of miseries. But markets reduce the material misery of mankind, and that is no small achievement.)

But what are we to think of Lane's (undeveloped) suggestions that the government reward high-tech or other "up-skilled" firms,

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or that it do things to penalize firms that supply low-skilled jobs, or that it pursue full-employment policies even at the expense of lower economic growth? Were he to write a companion volume, perhaps entitled *The Government Experience*, he would surely say that governments know even less than markets about true human happiness. And he would also note that, even if government had the requisite knowledge, its efforts to implement those ideas are likely to be ham-fisted and destructive of other values (such as liberty and prosperity).

Human happiness is an elusive but imperishable goal. Professors do not understand it, governments cannot produce it. We are blessed to be living in a society that has embraced an economic order and political system that permit us, with some reasonable prospect of occasional success, to pursue happiness. That is the most we can ever hope for.

NOTES.

1. A harsh judgment, but consider this sentence from page 245: "For reasons that seemed to include some inference that because the factory was so powerful its individual members were also powerful, and to point to the use of effective models among foremen and engineers, length of time in the factory was positively and strongly correlated with a measure of overall individual modernity embracing the sense of personal efficacy."
2. See, for example, David M. Buss, *The Evolution of Desire* (New York: Basic Books, 1994), 22–25.
3. Robert E. Lane, "Does Money Buy Happiness?", *The Public Interest* no. 113 (Fall 1993): 56–65.

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Peter Rutland

THE END OF THE SOVIET UNION: DID IT FALL, OR WAS IT PUSHED?

Peter Boettke's Why Perestroika Failed *offers an overly mechanistic explanation for the collapse of the Soviet economy, derived from Mises's theory of the economic impossibility of socialism. Arguing that the economic system was doomed to fail does not explain why it fell precisely when it did. Thus, Boettke underestimates the extent to which elements of the Communist nomenklatura themselves came to realize that their interests could be served by ditching the command economy. Such an emphasis on the role of human agents is surely compatible with a Hayekian approach.*

In *Why Perestroika Failed: The Politics and Economics of Socialist Transformation* (New York: Routledge, 1993), Peter J. Boettke tackles the most puzzling question facing social science in the 1990s: why did the Soviet system collapse when it did? The author is a convinced libertarian, and seeks to use Hayekian logic to analyze the demise of the century's most dangerous and long-lasting empire. The book is stimulating and provocative, although the fact that the book had its origins in separately published papers probably accounts for several fundamental contradictions which the current reviewer perceives to run through the entire text. By confronting these contradictions, however, one uncovers hypotheses to add to the debate

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about the character of the Soviet system and the reasons for its demise.

The book serves three distinct purposes. It provides a Hayekian critique of central planning; it discusses the reasons for the failure of the New Economic Policy of the 1920s; and it analyzes the contradictions of perestroika. The presentation of the Hayekian framework is the most successful of the three. The discussion of NEP is accomplished enough, but the issue has been thoroughly covered elsewhere (including by Boettke), and there is a danger of overstating the parallels between the 1920s and the 1980s. The book leaps almost directly from NEP to perestroika, with very little discussion of the intervening fifty years of Soviet economic history. Empirical data for the post-NEP period is drawn from secondary sources.

The author begins by posing two interesting questions: "If socialism as an economic system was so inefficient, how could it have lasted for 74 years?" and "If market reforms are so desirable, why have all the transforming economies experienced an acute economic decline during the reform period?" (3).

No direct discussion of these questions ensues, although the reader can infer some possible answers from the rest of the book. The author does (3–6) clearly lay out six core propositions, which provide a useful framework for this review.

Boettke's Theses

1. "*Soviet economic strength was an illusion*" (3). Obviously, the Soviet economy was much weaker than official statistics proclaimed. However, it is one thing to berate the CIA for artificially boosting estimates of Soviet economic strength, and another altogether to claim that it was a mere "illusion." Hayekians believe that all aggregate statistics are illusions, so it could be that the author is merely claiming that Soviet GDP was illusory in the same way that U.S. GDP is illusory.

But he seems to be saying more than that. He subscribes to the view that much of Soviet industrial production was "negative value added" (i.e., the inputs were worth more than the outputs)(10). This interpretation could provide an answer to his second question—why radical reform has been accompanied by economic collapse. According to this view, the economic slump Russia has experi-

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enced since 1991 is illusory, since the lost industrial production was value-destroying and did nothing to promote living standards.

The fact remains, however, that Soviet economic growth was not completely illusory. Soviet citizens were clothed, housed, and fed, and even on the most skeptical reading of official data their living standards roughly doubled between the years 1955 and 1980. Boettke confines himself to showing that Russians lived worse than people in Western capitalist countries, and enjoyed a living standard "more appropriate to a Third World country than a world superpower" (35). This proves nothing. Russia was and is a "Third World" country, and there is little point invoking U.S. living standards.[1] The real puzzle is how this Third World country could defeat the *Wehrmacht*, put Yuri Gagarin into orbit, rival the United States in the nuclear arms race—and then meekly collapse. The reader is left to wonder how an "illusory" economy enabled the USSR to become a superpower (albeit a second-grade one).

The negative-value-added argument (much favored by the London *Economist*) is also an exaggeration. By imputing world market prices to the raw material inputs of Soviet industry, it can be shown that the output costs more than the input and is therefore not worth producing. However, this overlooks transport costs to and from Western markets, which can double the price of final products. It also ignores the fact that if Russia were to sell those raw materials on world markets, their price would fall. This is precisely what has happened in the past two years: Russian sales of copper and zinc have caused their price to plummet by 50 percent.

The Soviet economy was horribly inefficient, and cruelly twisted to favor national military strength. But it was not an illusion.

2. "*Socialism as originally conceived was (is) an economic impossibility*" (4). This is an uncontroversial assertion—but does not help us to understand the failure of perestroika. Of course, Mises did establish that socialism as conceived by nineteenth-century utopians was impossible, since no central planner could possibly process the amount of information required to run a modern economy. However, Soviet-style socialism was clearly not "impossible," since it existed for seventy-four years. (It was thus much more "possible" than fascism, which even in Italy lasted only twenty years.)

3. "*Mature Soviet-style socialism . . . is best understood as a rent-seeking*

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society with the main goal of yielding perquisites to those in positions of power" (5). In order to explain why Soviet socialism persisted for so long, Boettke reasons that there must have been some social group with a vested interest in its continuation. This group is, of course, the party nomenklatura. "The sole point of the system was to concentrate benefits on those in power and disperse the costs on the citizens" (8). Boettke paints the nomenklatura as a privileged elite that "lived like kings" (122). We are told that "each layer of the party elite from Politburo bosses to enterprise managers was a feudal lord" (69). "Party officials did not have to wait in queues, they shopped in special stores, lived in nice dachas and drove their zils [limousines]" (66). Moreover, even "what Gorbachev was up to can perhaps better be understood as a redistribution of patronage perquisites" (83). This "rent-seeking" view reminds one of Bates's classic work on the political elites of post-colonial Africa, who monopolize trade with world markets in order to extract surplus from domestic producers.[2]

No one would deny that the Communist Party elite was privileged. Privilege is always relative; compared to the lot of the average Soviet citizen, the meager favors Soviet bureaucrats enjoyed carried special value. However, comparisons with kings and feudal lords are inappropriate. The Soviet partocracy led one of the most miserable and fearful existences of any ruling class in history, and this fact helps explain its rapid demise in 1991. Consider the following points.

First, despite all the talk of special stores and luxurious dachas, the actual living standards of the nomenklatura were very modest, and in material terms fell well behind what would be considered adequate in any American middle-class suburb.

Second, only the super-elite, the top 10,000, had access to special privileges like stores and dachas. The majority of the 100,000 full-time party officials would be lucky if they jumped the waiting list for a two-room apartment, or swung a permit for a two-week holiday in Bulgaria. (Remember that in the United States there are more than a million millionaires.)

Third, enjoyment of these privileges was precarious and contingent upon the grace of the state. The favors could be threatened at any moment—by denunciation from a political rival, by membership in the wrong ethnic group, or by picking the losing side in political infighting. In the Stalin period, the privileges were more

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lavish, but bureaucrats faced almost certain death or imprisonment. The threat of incarceration was lifted from partocrats under Brezhnev, but fear of the loss of status remained. Top party officials did not in fact drive their own *zils*: they were driven in a state-provided *zil*, by a chauffeur who probably doubled as a police informer. In contrast to feudal lords, party officials had no independent power base, no castle to retreat into; they were totally dependent on the whims of their superiors. It would be more appropriate to build a model of socialist bureaucrats as risk-averse rather than rent-seeking.

Fourth, it was quite difficult for the nomenklatura to pass on their privileges to their offspring. They could not directly bequeath capital or real estate (most of their dachas were state-owned). Access to political power required a long apprenticeship within the lower ranks of the party bureaucracy, which few sons and daughters of the elite were willing to undertake. Connections could obtain access to a good education, however, and at least this could ensure a high-status career (sometimes with the chance of foreign travel).

This is the life of the Soviet elite as I observed it. To me it did not look like a "rent-seeking society." Only where there is wealth acquisition on the scale of an Emperor Bokassa, or the Saudi Arabian royal family, does it make sense to make personal greed the focal point of one's political analysis. The rent-seeking model is too simplistic, and it ignores the unique characteristics of the Soviet case: the ideology-driven creation of an authoritarian political system and a nonmarket economy.

Boettke notes that "those who had most to lose were those in positions of power" (71), but fails to add that they were also paradoxically the group with the most to gain from reform. In reality, it was the members of the nomenklatura itself who had a vested interest in launching perestroika. They realized that Russia was falling far behind the rest of the world, and were shocked on their travels abroad to see how puny were their own privileges. When, in the event, perestroika failed, most of them concluded that the old system was not worth saving, and that their own lives (and the lives of their children) would be better under a different system. Thus they abandoned the sinking ship of Soviet communism and took to the lifeboats of the transition economy.

It is hardly surprising, then, to find that at least 80 percent of the

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political elite running post-communist Russia are former members of the old party nomenklatura. (The same is true of Ukraine and Central Asia.) Most people know that Yeltsin was a regional party boss, but fewer are aware that the champion of market reform, Yegor Gaidar, was economics editor of *Pravda*. Nor should it be surprising that the privatization process launched in 1992 has been rigged to favor the transfer of property into the hands of the old managers. Many of the new businessmen are former party or KGB officials, due to their intelligence, language skills, foreign contacts, and above all their dense network of patronage ties (what David Stark calls "network capital").[3]

4. "*The basic organizational logic of politics conflicts with the logic of economic reform*" (6). This proposition is an extension of the rent-seeking model. Economic reform failed, Boettke implies, because of opposition from the established nomenklatura elite. A rational-choice theorist, Boettke believes that there is a universal logic to politics (and to economics), applicable in all societies. "From an organizational viewpoint, the real existing systems in East and West are the same—the difference lying in degree and not in fundamental kind—and can be studied and criticized by employing the same principles of economics. The economies of East and West are quasi-mercantilist, rent-seeking societies" (76).

Thus Boettke seems to argue that political processes in the USSR were basically similar to those in mature democracies like the United States (38). In both cases, powerful lobbies have emerged to uphold a vested interest in the preservation of the current system. In both cases, status quo interests are concentrated and easily organized, while the potential beneficiaries of reform are dispersed and politically weak. There is also a common informational asymmetry between the certainty of reform losses and the uncertainty of allocation of reform benefits. "Reform in a situation of such entrenched interests is a near-impossibility" and "endogenous reform seems impossible" (85) because current beneficiaries will not agree to a change that makes them worse off.

But in reality of course, reforms *were* introduced, and their failure brought the whole system crashing down. While the interest-group argument provides some insights, it is ultimately misleading to suggest that politics in the Soviet Union was essentially the same as anywhere else. Surely a Hayekian should distinguish between a

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tyranny and a democracy, even if it is a flawed democracy? (What other sort is there?)

While it is true that some political interests blocked Gorbachev's reform efforts, the essential problem with perestroika was more *economic* than political. If Gorbachev had understood the need for real market reform, he probably could have forced it on the bureaucrats—just as he effectively disempowered the Communist Party, and forced the military to withdraw from Eastern Europe. However, market reform was fundamentally incompatible with the logic of the command economy, and even radical reform probably would have triggered systemic collapse. Gorbachev's half-hearted efforts to introduce the market were just sufficient to cause the command economy to auto-destruct. Surely Boettke would accept such an argument. Indeed, it is puzzling why he did not make it the centerpiece of his analysis, rather than adopting the rational-choice perspective.

By pursuing the rent-seeking model Boettke leaves himself at a loss to explain the introduction of perestroika and the subsequent collapse of the USSR. If the partocracy had it so good, why would it risk reform, and why let the old system fall apart? Boettke offers no discussion of the social groups that lined up for and against perestroika. He implies that it sprouted fully armed from Gorbachev's brow—presumably because its appearance, and subsequent failure, were "inevitable" (4).

5. "*Without a credible commitment to economic liberalization, reform efforts are doomed to fail*" (8). "Credible commitment" is another rational-choice concept which Boettke deploys to help understand the failure of perestroika (ch. 6). It is perhaps even less appropriate than the rent-seeking hypothesis.

Rational-choice theorists talk about "credible commitments" as tools for overcoming the collective action problem. Even though all the members of society agree that they would be better off if society moved from A to B (from the status quo to reform), they may refuse to change their individual behavior for fear that other individuals will exploit these actions, such that society will not collectively move to B. The idea is similar to FDR's nostrum, "there is nothing to fear but fear itself": change will not happen unless people believe it will happen.

It takes considerable mental acrobatics to fit this model to the

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Soviet case. Boettke argues that "the inability to convey any kind of commitment to reform sealed perestroika's fate" (103). Can he really believe that if Gorbachev had made such a commitment, and preserved his alliance with the "liberal intelligentsia," the Soviet system could have been reformed? There is little in Gorbachev's history to suggest that he would ever willingly dismantle the Soviet political system. I would suggest that the Soviet system could not be reformed; it could only be destroyed. The author would probably agree with this, but does not say so explicitly, and often implies the opposite.

Did perestroika really fail because the masses, or the bureaucrats, did not believe Gorbachev was serious in his commitment to reform? This contradicts the rent-seeking model—which suggests that the nomenklatura blocked reform precisely because it *was* convinced Gorbachev was serious about reform. Perhaps Boettke means to suggest that if Gorbachev had mobilized the masses for reform, then the bureaucratic opposition would have been overcome. One can debate whether this *could* have happened, but there is no doubt that it did not *actually* happen.

Shifting forward to discussion of the post-Gorbachev period, Boettke suggests that it was also important for Yeltsin to unequivocally establish his commitment to reform, in order to get people to start behaving in a market-oriented fashion. "The most effective way out of this impasse is to reject all notions of gradualism and embrace a radical liberalization program that is implemented overnight" (9). Why should a commitment to an extreme program be more credible than a commitment to a gradual one? People may, after all, be less willing to believe that a radical program will actually be implemented. It is strange, moreover, to see a Hayekian rejecting gradualism, since for Hayek the gradual accumulation of experience is the key to sound social institutions. And who will design and implement this radical program, and what are their incentives for doing so? Boettke recognizes that one of the major paradoxes of reform is the question of where the political leadership will get the power to introduce the massive changes required. ("Decrees must come, as it were, overnight" [80]). This is a very Gorbachevian perspective, but most un-Hayekian in assuming that the demand for a public good (in this case, market reform) creates its own supply.[4]

Boettke fails to discuss the Chinese reforms, which have brought

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about major changes in the economy but were implemented in a gradualist fashion and without any credible commitment or dialogue with the people. Of course, the Chinese political and economic system may yet collapse, but so far the process looks more positive than the Soviet experience. The Chinese experience seems to contradict the conventional wisdom about Russian reform, since most of the liberal prerequisities for reform are lacking in China: the rule of law, clearly defined property rights, political liberalization, currency convertibility, and the lifting of trade restrictions.

6. "*Only a radical reform that changes the basic relationship between the citizen and the state can get a moribund economy back on track to progress*" (10). This proposition is unobjectionable; but the question remains, how do we bring about such radical reform? The statement contains a questionable faith in the inevitability of progress. Are all economies on a preordained track to progress and prosperity? And how is one to explain the success of the East Asian economies, which seems to have occurred without any radical change in the relationship between citizens and the state?

Unanswered Questions

Boettke's six propositions are intriguing, but they leave at least three questions still unresolved.

1. *Why did the USSR collapse?* The author repeatedly asserts that the Soviet system was "doomed to collapse" (4). Yet on page 8 we are told that "only an exogenous shock such as war, natural disaster, economic depression or an ideological revolution, could displace the intransigent interest group." The book does not explain which (if any) of these shocks took place.[5] More importantly, why should an exogenous shock be necessary, if the system was doomed to collapse? On page 104 there is a hint that governmental instability (and not an exogenous shock) may have had something to do with the collapse, but this is not pursued.

Clearly, Gorbachev's abortive launching of perestroika must feature as a proximate cause in any account of the Soviet collapse. Liberals must confront the unpleasant but plausible argument that if Gorbachev had been more willing to use repression, the system could have staggered on for a few more years. Boettke would

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probably respond that the economy was in terminal decline, and nothing the politicians did could arrest its degeneration. However, this is an open question, and work by Vladimir Kontorovich and Michael Ellman is challenging the view that the Soviet economy was disintegrating in the early 1980s.[6] Economic growth had ceased, but the institutional structure was still intact. No analysis has yet proved the existence of an economic "smoking gun" that doomed the Soviet economy to extinction.

Curiously, the book contains no discussion of the role of ethnicity in the breakup of the USSR, except the argument that "in a liberal environment [ethnic] conflicts will give way to harmonious and mutually-beneficial economic ties" (127). This statement is wildly optimistic, in light of the considerable evidence that economic growth can reinforce ethnic tensions.[7] From the Sikhs in Punjab to the Northern League in Italy, one sees a wave of rich regions seeking greater autonomy in order better to benefit from economic liberalization.

2. *Was the Soviet Union a market economy?* Boettke has faith not only in universal laws of politics, but also universal laws of economics. Thus he wants to believe that in some sense the USSR must have been subject to the laws of the market. He argues that the USSR was in fact "a market economy dominated by monopoly producers" (59). Market elements were also provided by the underground economy, which was symbiotic with the state economy (65–69).

True, there were market elements in the USSR. But it is an exaggeration to say that it was a market economy. If it was a market economy, why then was it doomed to collapse? Boettke affirms that "the defining characteristic of the real existing Soviet Union was monopolization" (112), and that "about 2,000 enterprises were the sole producers of specific products" (117). One can raise two objections to this line of argument.

First, as Silvana Malle has pointed out, Soviet firms were not monopolists in the conventional sense, since they faced no demand constraint.[8] Even a capitalist monopolist cannot sell as many goods he can produce, whatever the price. Yet that was precisely the situation *all* industrial producers faced in the Soviet economy. In other words, the command economy *was* different from market economies, and had laws of its own. Second, Boettke himself refers

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to the high degree of vertical integration in the Soviet economy, with 70–80 percent of engineering firms doing their own casting, forging, etc. (117). Thus official "monopolies" caused the spread of unofficial production. Officially there may have been only one producer of steel ladders, but in practice every factory made its own.

Economists are still trying to collect data to establish just to what extent, and in what sense, the Soviet economy was monopolistic. The answer may be that there were quasimonopoly producers, but primarily on a regional basis. An improvement in communications and transport could quickly eradicate these regional monopolies.

3. How wrong was Sovietology? Boettke takes a few unfair shots at the much-maligned Sovietological profession. We are told that "unfortunately, standard Sovietology did not pay enough attention to the unofficial system that sustained the official system" (71). This is not the case: two of the leading half-dozen economists studying the Soviet system, Gregory Grossman (Berkeley) and Vladimir Treml (Duke), almost exclusively focused their research on the underground economy. The massive $10 million Soviet Interview Project, which surveyed 4,000 emigrés, concentrated very heavily on second-economy issues. Of course, there was a lot we did not know about the underground economy—but one can argue that we knew even less about the official economy. The number of works studying economic management in specific sectors of the economy, or dealing with such basic issues as banking practices or accounting methods, can virtually be counted on the fingers of one hand.

The present reviewer would normally be the last person to leap to the defense of Western Sovietology. However, it is too easy to criticize the Sovietologists by assuming that we now understand what happened—when in fact we do not. Boettke argues that "if the disease that plagued the former Soviet economy was misdiagnosed, then that was because the basic anatomy of the Soviet system was little understood by the doctors of Sovietology" (43). However, mainstream Sovietology fully accepted that the Soviet economy was inefficient, and the diagnosis of its ills is almost identical whether one picks up a book by Boettke, Marshall Goldman, Anders Aslund, or any of the other commentators on the Soviet system. The question of whether the system was capable of

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reform, and how long it could last in the absence of reform, is still unresolved.

Whither the Russian Economy?

Toward the end of the book Boettke opens up a stimulating attempt to define a libertarian reform program. In Chapter 7, "Charting a New Course," he rejects contractarian (Hobbes/Buchanan) and moralistic (Locke/Nozick) approaches to explaining social phenomena. Instead he favors the Hume/Hayek emphasis on the evolution of social institutions through decentralized, competitive processes. With refreshing candor he admits that his approach is utopian. "What is required for the twenty-first century is a vision of a new, but workable utopia. A post-modern vision of politics and economics, if you will" (145).

Such is Boettke's faith in the power of autonomous social processes that he is willing to embrace developments which many others find morally unacceptable. For example, he advocates giving ownership rights straight to enterprise managers, on the grounds that they are most likely to have the necessary expertise, and will probably get control in the end anyway (122). While I agree with him on this point, I am less willing to accept his argument that restitution of nationalized property to former owners is a complicating distraction which only serves to delay the unleashing of market forces (136, 187n44). In the Czech case, for example, the restitution of 100,000 properties to their former owners created a core of property owners almost overnight, and provided an important signal that property rights would be respected (even forty years after they were violated).

Also, I am not convinced that free banking is a solution to the difficulties caused by Russia's acute lack of sound monetary instruments (124). Russia has willy-nilly created its own system of "free banking," and it is not a pretty sight. Russia's 2,000 plus "commercial banks" come in two varieties. First, most large state firms christened their accounting departments as "banks" and began issuing interest-free credits to themselves and their suppliers. The remainder were set up by "*biznesmeny*": men with guns and suitcases full of money, whose main assets are a fleet of Mercedes sedans. The breakdown of the state banking system and the credit squeeze

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of 1992 meant that firms stopped using bank transfers altogether, and had to purchase everything (up to and including passenger aircraft) for cash. Exponents of free banking will argue that these are mere teething troubles, and that good securities will drive out the bad in the long run. The current state of the Russian economy reminds one of Keynes's dictum that "in the long run, we are dead." Some Russian bankers will not even make it to the long run: two or three are assassinated each month.

As an exercise of human imagination, Boettke's muscular libertarian utopianism is to be welcomed. But is this what Hayek had in mind when he rejected constructivist rationalism? How does Boettke deal with the central paradox of Hayekian economics: where do the rules come from? If rules are the result of self-generating social processes, why are most societies, most of the time, such a mess? Why do so few of them come anywhere close to the Hayekian ideal?

The Soviet experience shows not just the poverty of socialist philosophy, but also the poverty of neoclassical economics, which has provided neither a satisfactory explanation of why the Soviet system fell, nor a reliable route map to a more stable economic future. Hayekian approaches may not yet have provided answers to these conundrums, but by showing a willingness to question political interests and institutional structures, they are at least steering the debate into the right area. Boettke's work shows that Russia's tragic history provides an extraordinary laboratory for the application of Hayekian analysis. However, it remains an open question whether such public choice ideas as rent seeking and credible commitments can be used to augment the Hayekian model.

NOTES

1. Russian nationalists might complain that Russia in 1914 was the world's fifth-largest industrial power. However, as in the USSR, popular living standards lagged behind military status. Also, in 1914 even countries like Argentina were not "Third World" economies, but had higher living standards than the United States.
2. Robert Bates, *Markets and States in Tropical Africa* (Berkeley: University of California Press, 1981).
3. David Stark, "Recombinant Property in Eastern Europe," Harvard University Center for European Studies Program on Central and Eastern Europe, Working Paper no. 33, 1994.

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4. Boettke correctly notes on page 115 that "state action is by necessity non-neutral, i.e., intervention affects the underlying pattern and distribution of resources in society."
5. On page 86 Boettke argues that "the failed August coup provided the shock necessary," but this was not, of course, an exogenous shock.
6. M. Ellman and V. Kontorovich, eds., *Disintegration of the Soviet Economic System* (New York: St. Martin's Press, 1993).
7. Donald L. Horowitz. *Ethnic Groups in Conflict* (Berkeley: University of California Press, 1985).
8. Silvana Malle, "Privatization in Russia," paper delivered to the American Association for the Advancement of Slavic Studies, Honolulu, November 22, 1993.

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Geoffrey M. Hodgson

THE STATE, MONEY, AND "SPONTANEOUS ORDER"

In Monetary Evolution, Free Banking, and Economic Order, *Stephen Horwitz has provided an excellent review of the profound problems in the neoclassical theory of money and an important statement of the alternative Austrian-school approach. However, Horwitz's "free banking" perspective rests on a false dichotomy between intervention and spontaneous order. In using the extreme case of an entirely undesigned evolutionary process to counter the equally extreme proposition that social order can be wholly designed, Horwitz loses sight of the messy world of intermediate realities and possibilities. Even if money has strong spontaneous qualities, the state may play a vital role in the evolution of the financial system.*

Karl Marx aptly described money as "the God among commodities."[1] The metaphor of the deity rightly suggests that money has a supreme and unique role in a market economy, and appropriately alludes to its mysterious and impenetrable properties. The central function of money in a modern capitalist economy is manifest by its extensive use as a medium of exchange, unit of account, and store of value: "Money makes the world go round."

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Yet, as Steven Horwitz reminds us in his erudite and valuable book, *Monetary Evolution, Free Banking, and Economic Order* (Boulder: Westview Press, 1992), mainstream economic theory has failed to provide a convincing analysis of money and its role in a market economy. It is widely accepted that the dominant, neoclassical school of economics has failed fully to incorporate money in its essential theoretical framework, Walrasian general equilibrium theory. Amongst others, this failure has been admitted by leading general equilibrium theorist Frank Hahn: "Monetary theory cannot simply be grafted on to Walrasian theory with minor modifications. Money is an outward sign that the economy is not adequately described by the pristine construction of Arrow and Debreu."[2]

Horwitz's critical discussions of mainstream monetary theory are particularly to be recommended. He provides a superb survey of the central theoretical issues and the related literature, showing clearly that "the properties of real-world moneys throw a monkey wrench into the neoclassical theory of economic exchange" (15). This is because, first, neoclassical theory assumes either a world of perfect knowledge, or one in which the probabilities of all possible events are well described and known. Moreover, to differentiate money from other run-of-the-mill commodities, neoclassical economics typically assumes that money is itself not a direct source of utility for consumers. But if these assumptions were valid, why on earth would people hold onto money? We may barter, but why should we hold stocks of a typically non-interest-bearing asset whose value is realized only in the purchase of other commodities?

Exploring the common ground between Keynes's and the Austrian view of money, Horwitz argues that in the real world, an important reason for holding money is that it helps us deal with uncertainty. Here "uncertainty" is used in the broad sense of Frank Knight and John Maynard Keynes, referring to events for which there is no basis to calculate an appropriate probability. In an uncertain world we do not necessarily know what the expected benefits or losses of our actions may be because the probabilities cannot be known. In helping us deal with uncertainty, money serves as an asset, but not one we choose to possess according to any quantifiable utilitarian calculus. Neoclassical economic theory has effectively banished this form of uncertainty, generally confining itself to calculable probabilities.

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Horwitz favors the Austrian view that money has a subjective yield determined by its liquidity or "availability services." This contrasts with the approach in much of the Keynesian literature, where the liquidity and other properties of money are not cast in subjectivist terms. Another key difference with the Keynesian theoretical approach—as explicated in the writings of not only Keynes, but Shackle, Davidson, and others—emerges when Horwitz criticizes the Keynesians for the "overly exaggerated role given to conscious intent, in this case the state, both in the origin and the control of money." In contrast, Austrians such as Hayek argue that money and other complex institutions "cannot be explained simply by the intent of particular actors or groups" (36). It is not surprising, then, that Horwitz argues for "free banking": the idea that the issue of money should be "denationalized" and that private agencies should be allowed to issue money.[3]

The False Dichotomy of Freedom and Constraint

The founder of the Austrian school of economics, Carl Menger, provided an explanation of the "spontaneous" evolution of money that has attributes of the "coordination games" discussed by Edna Ullmann-Margalit.[4] Once a unit begins to emerge, it establishes a "convention" with strong "network externalities." Like other such conventions, such as language or driving on the same side of the road, the network externality effect is that we are impelled to use or do something because it is used or done by others.

In the "free banking" literature, Menger's evolutionary tale is used too readily to sustain a dichotomy between "free" and "regulated" banking. Horwitz touches on this problem in his illuminating section on "the false dichotomy of rules versus discretion" (125ff.). But here his observations are specifically concerned with the dilemma, presented in the neoclassical literature, between giving a central bank the freedom to exercise discretion and binding it to behavioral rules. Horwitz ably escapes the horns of this particular dilemma but, as argued below, he imposes equally false dilemmas of his own. The Mengerian story of the evolution of money suggests that constraints on behavior evolve even in a "free" monetary system.

Everyday life presents us with all sorts of institutional con-

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straints. In some cases the constraints are so severe that the available alternatives provide us with little real choice. Although we are not punished if we do otherwise, we are virtually compelled to speak English in English-speaking countries, to use either Macintosh or IBM-compatible personal computers, to utilize VHS video recorders, and to adopt the dress and manners of the social culture in which we are immersed. Yet all these outcomes emerge in a largely "free" and competitive framework, in which state compulsion has not been crucial.

While freedom and compulsion should not be conflated, the dichotomy between them is not as simple as is often assumed. Indeed, some kinds of rules and compulsions can lead to freedom. For example, the institution of language provides us with a limited choice of meaningful utterances, yet in doing this, it enables us to communicate an immense variety of statements and feelings. The adoption of a single, common language enables people in a community to communicate with one another and the freedom to do things, singly or together, which otherwise would not be possible. Similarly double-edged effects are found in the realm of law. For example, effective laws compelling food manufacturers to list all ingredients increase the freedom of individuals to make informed choices of what they eat.

All institutions have both constraining and enabling qualities. In particular, by establishing more-or-less fixed patterns of human action, institutions supply us with information about other agents by suggesting what they might do, so one can act accordingly. If these rigidities or "imperfections" did not exist, the behavior of others could change with every circumstantial perturbation. In a highly complex and uncertain world, institutional constraints make regular and predictable behavior possible.[5] Thus institutions, not simply despite, but also because of, their very rigidity, act as enablers of human action.[6]

In monetary theory, then, the exercise of freedom should not necessarily be identified with the existence of a system of competing currencies, as orginally advocated by Hayek.[7] Indeed, through a process of Mengerian selection, a "free" banking system may well result in the dominance of one type of currency. Such an outcome has the benefit of reducing the informational difficulties and transaction costs involved in a multicurrency scheme. Accordingly, a

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state-enforced single currency could be similar to the outcome of a "free" monetary policy.

The False Dichotomy of Pragmatic and Organic Institutions

Menger distinguished between organic institutions, which arise from a process of spontaneous social evolution, and pragmatic institutions, which result from conscious enactment and design. Although this distinction is not without value, it is far from clear that the two catgories are mutually exclusive. Arguably, most real-world organizations are the result of a mixture of both organic and pragmatic processes.

Writers of the modern Austrian school typically suggest that the categories are mutually exclusive, and that purely organic institutions are not only possible, but generally more robust. Horwitz is no exception. In asserting that money and other complex institutions "cannot be explained simply by the intent of particular actors or groups" (36), Horwitz does not consider the intermediate possibility that money and other complex institutions could be explained *in part* by the intent of particular actors or groups. Consequently, he suggests such institutions can emerge *wholly without* the design or intent of particular actors. Here he seems to suggest that completely undesigned institutions are possible, whereas completely designed ones are not. In attempting to defend one extreme case, Horwitz emphasizes the problems with its polar opposite, losing sight of the middle ground, the world of messy hybrids in between. Whether by intention or not, Horwitz creates a false dichotomy.

The same false dichotomy emerges elsewhere in the book. Thus, Horwitz writes: "Money is a product of individual voluntary action; no act of state intervention can 'create' a money" (169). Yet few economists have argued that money can be created *simply* by decree. Horwitz ignores the very real possibility that money and other major institutions can result from the *combination* of "individual voluntary action" and state intervention.

The key concept here is Hayek's idea of spontaneous order, of which money is an often-quoted example. Such orders are said to be generated as a result of the interaction of rule-following behaviors by individual agents. Yet as Stephan Boehm has pointed out, it

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is possible for a spontaneous order to arise on the basis of deliberately designed rules.[8] Such rules could even be enforced by the state. This suggests that there is no complete bifurcation between organic and pragmatic institutions: even spontaneous orders may have designed elements, just as organizations arising by design may also encompass elements of unforeseen spontaneity.

Perhaps a more appropriate distinction should be drawn between *organizations*, which function primarily through authority and command, and *customs*, such as language and table manners. But even this distinction is problematic, notably in regard to the market. In addition to depending on laws of property and contract, some markets are clearly organized and regulated, whereas others sustain themselves without much overall direction. The market is an institution, and no institution is free of elements of compulsion and control. Yet some institutions, such as firms, typically involve a higher degree of authority and command, and others, such as markets, rely more on the undirected interactions of individuals according to prescribed rules.

The Evolution of Money and the Role of the State

The case of money is complex, as the history of monies and monetary institutions shows. A key question is whether a viable monetary system can evolve in a purely undesigned way. This is largely a theoretical issue: rarely has such a purely spontaneous system evolved in history. It has been argued that the Mengerian parable ignores the problem of disguised quality variation with the monetary unit—forgery and debasement being extreme examples—and the associated problem of verifying note and coin.[9] With potential quality variation, the purity and value of the emerging monetary unit may be in doubt. Some actors, noticing the high frequency of the trade in a particular commodity, may deem the commodity unreliable and thereby avoid it as a medium of exchange. Such information problems, arising from potential quality variation, could subvert the evolution of the monetary unit. Despite the noted emphasis of the Austrian school on subjectivity and divergences of perceptions, this particular problem of information and knowledge is generally ignored in presentations of Menger's theory.[10]

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I do not suggest that Menger generally ignores problems of information and uncertainty; it is well established that he was one of the first major economists to give them precedence. However, the particular problem of quality variation is sidestepped by his implicit assumption that the emerging monetary substance is invariant and recognizable by all agents. Given potential quality variation, the spontaneous evolution of the monetary unit may break down, possibly requiring the intervention of the state or central bank to maintain it. Clearly this contention requires further examination than is possible here, but it is not difficult to imagine circumstances where such a breakdown could occur. In sum, there are good reasons to assume that money may have to be partly a "pragmatic" rather than a purely "organic" institution.

Symbol, Legitimation, and Trust

Furthermore, theoretical models of the evolution of money do not always demonstrate convergence to a viable outcome. Arguably the state has had an important and unique guiding role in history, and its functions in this regard may well be indispensable. If the Mengerian "coordination game" is protracted and erratic, then the emergence of a strong coordination authority may well be helpful.

Imagine a state of anarchy in which no one knows on what side of the road to drive, and in which a widespread convention is slow to emerge. An announcement by the state that everyone should drive on the right might well be very helpful, even if no compulsion is involved. The positive and perhaps indispensable role of the state here does not mean that the spontaneous and voluntary reinforcement by individuals of the reigning convention, once it has emerged, is unimportant. On the contrary, the voluntary aspect is essential for the new convention to be established and maintained. But it is not the whole story. There may even be a case for supplementing the voluntary process with legal penalties for driving on the "wrong" side.

Similarly, the state plays a very powerful and possibly indispensable role in the creation and maintenance of money. This does not mean that it is infallible or incapable of abusing its power. However, in legitimating a monetary system and helping to engender trust in the monetary unit, the state relies on crucial symbolic as

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well as legislative powers. It is not accidental that the images of monarchs and presidents adorn notes and coin. It is also no accident that the words "God" and "trust" are placed alongside symbols of nationhood on the U.S. dollar.[11]

Regrettably, this approach to the analysis of money is underdeveloped. Such a theory could well make use of Max Weber's concept of legitimation to examine both the "rational" and "traditional" bases of money. For surely its legitimacy rests both "on a belief in the 'legality' of patterns of normative rules" and "on an established belief in the sanctity of immemorial traditions and the legitimacy of the status of those exercising authority under them,"[12] as well as on the spontaneous interaction of individuals. In recognizing that money does not emerge wholly as a matter of state decree, and that its evolution has much to do with individual action and decision, the errors in extreme versions of the "state theory of money" could be avoided,[13] and the potential abuse of the power of the issuing state authority could be addressed.[14]

Such a theory would recognize that the "traditional" grounds for the legitimation of money rest in part on the use of symbols of state authority. As Herbert Frankel puts it in his study of money: "Individuals and societies are dependent on countless symbols, myths, beliefs and institutions which function as indicators of trustworthiness or the opposite."[15] In this regard, the traditional authority of the state is unsurpassed.

One may anticipate a number of possible "Austrian" responses to this amended version of the "state theory of money." A first would be to suggest that it neglects the spontaneity of the evolution of the monetary system. As suggested above, this would be a misunderstanding: the emergence of money involves *both* spontaneity and design. A second would be to point out the limitations of the state, and the past and potential abuses of state financial power. This objection is really irrelevant: whatever the limitations of the state, it may also have positive coordinative and legitimating functions. A third would be to accept that the state has a capacity to use its symbolic and legitimating powers, but to argue that these work *only* because they affect the expectations, perceptions, and wants of individuals. Accordingly, this version of the "state theory of money" undergoes a metamorphosis, and turns into the Mengerian and individualist account.

However, as I have argued elsewhere,[16] it is not convincing to

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reduce explanations of complex phenomena to one element, whether individuals, in the case of the Austrian school, or "labor" in Marxian value theory. In common with their neoclassical adversaries, Austrians make no theoretical place for the factors that help to mold individual cognitions and preferences. To assert—rightly in my view—that human choices and preferences are to some extent indeterminate does not mean that it is impossible or undesirable to examine the pressures and constraints that bear upon these preferences. An alternative Austrian response is to assert that analyzing the formation and molding of individual goals and preferences is not a matter for economics, but for psychology. This is simply the imposition of a disciplinary Berlin Wall, and should not be taken too seriously by those who value freedom of inquiry and yearn for the fullest possible understanding of the real causal processes behind social and economic phenomena.

Here lies the real root of the difference between Austrian economics and institutional economics in the tradition of Veblen, Commons, and Mitchell. An institutional economist should not deny the genuine insights in the Austrian monetary literature. At the same time, the institutionalist contribution should be recognized. In particular, like Weber before him, the institutionalist Wesley Mitchell argued that the historical emergence of money cannot be explained simply because it reduced costs or made life easier for traders.[17] The penetration of money exchange into social life altered the very configurations of rationality, stimulating the peculiarly modern conceptions of abstraction, measurement, quantification, and calculative intent. The ingrained habits of loyalty and subservience that impelled ordinary people during the feudal order were gradually displaced by a new mentality of individual calculation and gain according to a common unit of account.[18] Money thus transformed individuals and their habits and promoted new institutions, constraints and rules. And the state played an important part in this process.

A great merit of Horwitz's book is that it brings these controversial theoretical issues to the fore. At the same time, one becomes acutely aware of how much more work remains to be done in monetary theory to develop a fully satisfactory explanation of this vital and central phenomenon. Horwitz's book is a highly significant contribution to this endeavor.

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NOTES

1. Karl Marx, *Grundrisse: Foundations of the Critique of Political Economy*, trans. by M. Nicolaus (Harmondsworth: Penguin, 1973), 221.
2. Frank H. Hahn, "On Monetary Theory," *Economic Journal*, 98, no. 4 (December, 1988): 972.
3. Free banking has previously been advocated by Friedrich A. Hayek, *The Denationalisation of Money* (London: Institute of Economic Affairs, 1976), revised and reprinted in idem, *Economic Freedom* (Oxford: Blackwell, 1991); George A. Selgin, *The Theory of Free Banking* (Totawa, N.J.: Rowman and Littlefield, 1988); and George A. Selgin and Lawrence H. White, "The Evolution of a Free Banking System," *Economic Inquiry* 25, no. 3 (July 1987): 439–57. However, Horwitz does not discuss the "laissez-faire" rival, "cashless competitive payments system" put forward by Robert Greenfield and Leland Yeager, who propose that the government should define the unit of value but should be forbidden to issue money. The Greenfield-Yeager idea has opened up an interesting theoretical controversy within the "laissez-faire" camp which could have been usefully explored. (See Robert L. Greenfield and Leland B. Yeager, "A Laissez-Faire Approach to Monetary Stability," *Journal of Money, Credit and Banking* 15, no. 3 [August 1983]: 302–315.)
4. Carl Menger, *Principles of Economics*, ed. J. Dingwall, trans. B. F. Hoselitz (New York: New York University Press, 1981 [1871]); Edna Ullmann-Margalit, *The Emergence of Norms* (Oxford: Oxford University Press, 1977).
5. Lawrence A. Boland, "Knowledge and the Role of Institutions in Economic Theory," *Journal of Economic Issues* 13, no. 4 (December 1979): 957–72; Geoffrey M. Hodgson, *Economics and Institutions: A Manifesto for a Modern Institutional Economics* (Philadelphia: University of Pennsylvania Press, 1988); Geoffrey Newman, "An Institutional Perspective on Information," *International Social Science Journal* 28 (1976): 466–92; Andrew Schotter, *The Economic Theory of Social Institutions* (Cambridge: Cambridge University Press, 1981).
6. John R. Commons, *Institutional Economics: Its Place in Political Economy* (New Brunswick, N.J.: Transaction, 1990 [1934]): 73; Anthony Giddens, *The Constitution of Society: Outline of the Theory of Structuration* (Cambridge: Polity Press, 1984).
7. Friedrich A. Hayek, *The Denationalisation of Money* (London: Institute of Economic Affairs, 1976).
8. Stephan Boehm, "Spontaneous Order," in Geoffrey M. Hodgson, Warren J. Samuels, and Marc R. Tool, eds., *The Elgar Companion to Institutional and Evolutionary Economics* (Aldershot: Edward Elgar, 1994), 296–301.
9. Geoffrey M. Hodgson, *Economics and Evolution: Bringing Life Back Into Economics* (Ann Arbor: University of Michigan Press, 1993), ch. 8.
10. Notably, Menger himself raised this problem, yet it is ignored in other accounts of his theory, and particularly in those of his followers. In his

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1909 encyclopedia article "Geld" (reprinted in *The Collected Works of Carl Menger*, vol. 4, *Schriften über Geldtheorie und Währungspolitik* [London: London School of Economics, 1936], 1–116), Menger discussed the problem of quality variation and recommended state monopoly of coinage as a safeguard.

11. For a useful discussion of the complex role of trust in a monetary system see Herbert S. Frankel, *Money: Two Philosophies; The Conflict of Trust and Authority* (Oxford: Blackwell, 1977).
12. Max Weber, *The Theory of Social and Economic Organization*, ed. Talcott Parsons (New York: Free Press, 1947), 328.
13. The most famous example of the "state theory of money," with its many inadequacies, is Georg F. Knapp, *The State Theory of Money* (London: Macmillan, 1924).
14. Note that Weber (299–309) criticized Knapp's state theory of money. The thrust of his criticism was that state power was not enough to constitute money; a system of paper money without a metallic standard would possess "only a relative degree of formal rationality" (308). For this reason Weber advocated a metallic standard to supplement, rather than replace, the "legitimate authority" of the state. Note that despite this criticism of Knapp, Weber does not reject the state theory of money per se.
15. Frankel, 37.
16. Hodgson, *Economics and Institutions*, ch. 3; idem, *Economics and Evolution*, ch. 11.
17. Wesley C. Mitchell, *The Backward Art of Spending Money and Other Essays* (New York: McGraw-Hill, 1937), 175–76, 305–306.
18. Since 1989 we have observed much more rapid, but nevertheless substantial, changes in individual mentality in the transformation of the former Communist countries from planned into market-based systems. The failure of many economists to consider the scale of the psychic and cultural transformation involved partly accounts for the widespread and rather misguided faith in the rapid and spontaneous emergence of markets and other capitalist institutions once the shackles of the old order were removed. Events have shown that the process is necessarily much slower and deeper than had previously been presumed. See G. M. Hodgson, "The Evolution of Socio-Economic Order in the Move to a Market Economy," *Review of International Political Economy* 1, no. 3 (Autumn 1994): 387–404.

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George Selgin

ARE BANKING CRISES FREE-MARKET PHENOMENA?

The conventional view of banking crises sees them as an inherent problem of fractional-reserve banking systems. According to this view, government regulation in the form of an alert central bank (acting as a "lender of last resort"), or deposit insurance, or both is needed to keep isolated bank failures from generating systemwide panic. But this view does not mesh with historical experience, which points to government regulation itself as the most likely cause of banking crises.

What causes banking crises, involving a general loss of confidence in banks? Practically everyone believes that they are an inherent part of fractional reserve banking, and that government agencies alone are capable of preventing them. Even many persons who otherwise believe in free markets and who are critical of government regulation of banks generally accept the need for some kind of government intervention to prevent or otherwise deal with occasional banking crises. This conventional view of banking crises is so generally accepted that its truth is often simply taken for granted by policy makers, who seldom bother to examine it critically. Nev-

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ertheless, a close look at the theory underlying it highlights certain empirical implications that turn out to be quite at odds with reality.

The Conventional Theory of Banking Crises

A banking crisis erupts when many or all banks in a banking system are confronted by large-scale demands to redeem their liabilities in cash, which demands the banks are unable to satisfy. In attempting to satisfy the demands, banks in a fractional-reserve banking system must undertake large-scale reductions in their balance sheets, shrinking available supplies of money and credit.

If banks held 100 percent reserves, they could redeem all their liabilities at once if they had to without precipitating a crisis. A 100-percent reserve banking crisis is an impossibility. Some conservative thinkers, including past Chicago-school economists Henry Simons and Lloyd Mints,[1] view this fact as reason enough for condemning fractional-reserve banking and for recommending its replacement with some 100-percent-reserve alternative. Such a stance takes for granted not only that fractional-reserve banking systems are inherently unstable, but also that fractional-reserve banking is not a source of potential welfare gains to society. Both claims are of doubtful validity, the first for reasons to be made clear in the text, and the second because it overlooks the benefits fractional-reserve banking provides in harnessing money holdings as a vehicle for funding investment. Under competitive conditions the latter benefits are partly enjoyed by money holders themselves, whose gain takes the form of explicit interest payments, lowered bank service charges, or some combination of each.

A second feature of the banking system upon which the conventional theory relies is that bank deposit contracts are serviced on a "first-come-first-served" basis: when persons come to redeem their deposits in cash, their banks pay them in the order of their arrival. Those who are first in line therefore face the highest probability of getting their deposits cashed, while those who are last in line face the lowest probability. This assumption is important, because it serves to motivate runs on individual banks. Such runs play a crucial part in the conventional theory of systemwide banking crises.

Granting these basic assumptions, how does a crisis occur? Ac-

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cording to the conventional theory, the crisis is triggered by some "shock" to the banking system. This shock may exist only in the minds of some depositors, making the crisis a kind of self-deflating financial "bubble," or it may be a real event.[2] In either case, the shock must be assumed to threaten at least one bank's liquidity or solvency and, hence, its ability to satisfy its customers' demands for cash. The perception that any bank is having difficulties by itself is sufficient to trigger a run on the bank, for reasons that are obvious enough in light of the "first-come-first-served" way in which withdrawals are handled.

This conventional explanation of how a run against a single bank might occur is still a long way from a plausible story about a banking *crisis* involving simultaneous runs on all or many of a nation's banks. Clearly it is such a crisis, and not runs on single banks or small numbers of banks, that matters: if only a small number of banks is affected by runs, then persons running on those banks would have no reason to abandon the banking system altogether by hoarding cash. Such persons would instead merely transfer their savings (or as much of them as they have been fortunate enough to recover) to other, unaffected banks. Such limited runs, unlike a true banking crisis, do not end in a collapse of money and credit, and so are really no more important than a loss of market share by some limited group of firms in any industry.

How, then, may individual bank runs and failures be transformed into a true banking crisis? One possibility is an external shock that threatens to undermine the solvency of most or all banks simultaneously. It is difficult, though, to imagine a shock that could have such an effect on a large and heterogeneous banking system. Assuming that the banking system as a whole, if not individual banks within that system, is well diversified, it would seem that only a foreign invasion, a civil war, or some massive monetary shock not originating in the private banking system itself could have such a devastating effect. The conventional theory of crises does not, however, portray banking crises as a wartime phenomenon only or as one linked to any particular monetary policies. The theory must, therefore, rely on some mechanism other than wars and monetary policy shocks to account for "typical" crises.

It is here that the conventional view resorts to a "contagion effect" hypothesis, which holds that a run on any bank is likely to spread like an infectious disease to other banks, eventually under-

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mining confidence in all. Why are bank runs contagious? The most popular explanation appeals to what are technically referred to as "information asymmetries" in the market for bank deposits. Although each banker knows the contents of his asset portfolio, most depositors do not, so they are inclined to assume that all banks are more or less alike. Because of this assumption, whenever any one bank is seen to be in difficulty, either because it has already failed or because it is being run upon by its customers, other ill-informed depositors immediately begin to worry that their own banks may also be in trouble. Rather than take a chance, and realizing that if they are to recover their deposits, they must redeem them before others have received all the cash, they run on their banks. A crisis thus ensues, with the shadow of distrust cast simultaneously upon all banks.

It is important to realize that, according to the conventional view, contagions are not extraordinary events but are likely to take place in any banking system unprotected by deposit insurance or a vigilant and dependable central bank. A presumption exists, therefore, that the authorities must guard against each and every bank failure if they are to succeed in avoiding banking crises, or must otherwise insulate the banking system from contagions by offering comprehensive insurance to depositors. Otherwise, individual bank runs or failures will occasionally lead to breakdowns of the whole system of money and credit.

Some Evidence against the Conventional Theory

The conventional theory of banking crises has guided banking policy in the United States and elsewhere for many decades. It has been used to rationalize many kinds of restrictions on banking, ranging from minimum reserve and capital requirements to various interest rate and bank portfolio restrictions. It has also led to the proliferation of government-run deposit insurance schemes, despite the well-known hazards associated with them. Finally, it has helped justify the extension and consolidation of central bank powers and privileges, encouraging those few nations still lacking their own central banks to view their arrangements as inherently unsafe and economically backward.

Yet for all its wide-ranging influence, the conventional theory of

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banking crises appears to fail the most elementary kind of empirical test. The theory implies not only that crises are likely in any fractional-reserve banking system, but that they are especially likely in systems lacking any public lender of last resort or government deposit insurance. Readily available historical evidence, however, contradicts both claims. Tables 1 and 2, derived from the only international surveys of banking crises of which I am aware, suggest that genuine banking crises have been rare in most well-studied fractional-reserve banking systems and entirely absent in several. Moreover, many of those systems that appear to have had few or no banking crises also lacked both deposit insurance and a lender of last resort.

I am not aware, furthermore, of any reason for suspecting that these relatively crisis-free banking systems were subject to fewer or less severe shocks than relatively crisis-prone ones. For example, it appears that in most respects Canada was just as "shocked" as the United States was by the post-1929 collapse of prices and incomes. Yet while the United States banking system soon suffered its worst banking crisis ever, Canada suffered no banking crisis—indeed, no bank failures—at all. Likewise, while the English banking system was battered by numerous shocks throughout the nineteenth century, Scottish banks seemed relatively immune. Because it can account for cross-country differences in the incidence of crises only by appealing to corresponding differences in the incidence of fundamental shocks (or perceptions of shocks), the conventional theory of crises seems hard-pressed to explain the actual incidence of crises in various times and places.

Faced with this evidence of the conventional theory's failure, one cannot help wondering how it managed to become so popular in the first place. Another look at the historical incidence of banking crises suggests an explanation. As the tables show clearly, banking crises appear to have been a U.S. specialty, with England earning second place in the banking crisis marathon. Most of our economic theories, including the conventional theory of banking crises, come from British and especially American economists, who know much more about the economic histories of their own countries than they know about experiences elsewhere. It is no wonder, therefore, that the received theory of banking crises appears, superficially at least, to fit the historical record of the United States and England, while bearing little con-

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Table 1: Banking Panics, 1793–1933: "Unfree" Banking Systems

Year of Panic	United States	England	France	Germany	Italy
1793	x	x	—	—	—
1797	x	x	—	—	—
1810	x	x	—	—	—
1815	x		—	—	—
1819	x		—	—	—
1825	x	x	—	—	—
1833	x		—	—	—
1837	x	x	—	—	—
1839	x		—	—	—
1847	x	x	x	—	—
1848			■	—	—
1857	x	x	x	x	—
1864			x		—
1866		x			—
1873	x			x	—
1875				■	—
1882			x[a]		—
1884					—
1889			x		—
1890					—
1891					x
1893	x				x
1894					■
1901				x	
1907	x				
1913				x	
1914	x■				x
1921					x
1930	x		x		
1931	x			x	
1933	x				

Sources: Bordo, "Financial Crises," n4 below; Schuler, "World History," n6 below; and Schwartz, "Financial Stability," n4 below.

Note: [a]Large bank failure.

nection to the experiences of many other nations. Even critics of the received theory have played into the hands of its proponents by relying solely on U.S. experience to refute conventional assumptions, when evidence from other nations would make their task much easier.[3] On the other hand, the few writers who have

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Table 2: Banking Panics, 1793–1933: "Free" Banking Systems

Year of Panic	Canada	Scotland	Sweden	Australia	China	South Africa
1793	—		—	—	—	—
1797	—	x[a]	—	—	—	—
1810	—		—	—	—	—
1815	—		—	—	—	—
1819			—		—	—
1825			—[b]		—	—
1833					—	—[c]
1837	x[d]				—	
1839					—	
1845		■			—	
1847					—	
1857					—	
1864					—	
1866					—	
1873					—	
1882					—	
1884					—	
1889					—	
1890					—	
1891						
1893				x		
1901			■			
1907			x			
1911				■		
1914	x[e] ■					
1920						x[f] ■
1923	x[g]					
1930						
1931						
1933						

Sources: Same as Table 1; also Lars Jonung, "The Economics of Private Money: The Experience of Private Notes in Sweden, 1831–1902," unpublished working paper, Stockholm School of Economics, 1989; and Lawrence H. White, *Free Banking in Britain: Theory, Experience and Debate, 1800–1845* (Cambridge: Cambridge University Press, 1984).

Notes: [a]Restriction of payments. [b]Swedish free-banking era begins. [c]South-African free-banking era begins. [d]Listed as a crisis year by Schuler, but not by Schwartz. [e]Minor runs caused by binding capital requirements for note issuance. [f]Inflation follows abandonment of gold standard during World War I. [g]Major bank failure accompanied by minor runs on other banks.

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actually surveyed international experience tend to focus too much on comparing the United States with the "United Kingdom" (meaning England) in drawing general conclusions from their surveys.[4] These writers are thus led to credit the presence of an "effective" or "dependable" public lender of last resort as the most important reason for the relative infrequency of panics in certain countries during certain periods, ignoring the more numerous cases (including those shown in Table 2) in which panics were avoided despite the absence of a public lender of last resort.

Behind our first empirical observation—that banking crises have not been equally frequent everywhere—lies another: that bank failures typically have not been contagious, or have been only mildly contagious. All banking systems have seen individual banks fail, but such failures have only rarely led to runs on most other banks. (Even in the United States, whose banking system has suffered more bank failures and experienced more crises than any other, wide-ranging bank contagions have been few and far between.)[5] This observation is supported both by direct evidence concerning the extent of bank runs and by statistics on the demand for legal tender, which should, other things being equal, increase whenever panic becomes general.

In fact, of well-studied episodes, only the U.S. crisis of 1933 appears to have involved a truly systemwide panic. Apparently this single episode has inspired the conventional view of banking crises. Yet I shall argue later that even it does not lend any real support to conventional views concerning the nature of banking crises.

These considerations suggest that the conventional theory of banking crises is seriously inadequate. Yes, banking crises do occasionally occur, and at least one appears to have involved a nation's entire banking system. But far from being a typical or likely consequence of isolated bank failures or runs, genuine banking crises appear to be relatively unusual events, and events that are more unusual in some banking systems than in others. Clearly, there is a need for some alternative theory capable of shedding light on why banking crises have occurred in certain times and places, but not in others, despite the common ingredient of individual bank failures.

Another casual look at the evidence suggests the basic outlines of such an alternative theory by revealing, perhaps counterintuitively, that banking crises have been *more* frequent in heavily regulated banking systems than in relatively unregulated ones. Drawing on a

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survey by Kurt Schuler,[6] Table 1 lists banking systems which, throughout their histories, have been subject to at least two "major" regulatory restrictions, while Table 2 lists systems that were, for a time at least, characterized by no more than one major restriction. Although "free" for a while, the Table 2 systems were all eventually rendered unfree by additional major restrictions, usually consisting of restrictions on competitive note issuance anticipating or inaugurating the establishment of central banks.[7] Such restrictions are indicated in the table by black boxes showing dates when the new restrictions were imposed. Similar boxes in Table 1 mark dates when privileged banks of issue capable of serving as "lenders of last resort" were established in previously "unfree" (but nonetheless decentralized) banking systems. No box appears in the column for England because the Bank of England already possessed unique note issue privileges there before 1793—the first crisis date recorded on the table.

This grouping of banking systems reveals clearly the positive connection between the extent of legal restrictions on various banking systems on one hand and the number of banking crises experienced by those systems on the other. Of forty-eight recorded crises, all but seven (one of which is listed as a crisis in only one of two surveys employed) occurred in unfree systems. Furthermore, nearly half of the crises took place in systems having privileged banks of issue that might, in principle, have served as lenders of last resort. This suggests that the presence of a public lender of last resort has, after all, been neither necessary nor sufficient to prevent the occurrence of banking crises. Of course, defenders of central banking might still insist that the presence of an "effective" or "dependable" lender of last resort is sufficient to prevent crises. Such a stance appears, however, to require an overly convenient definition of "effectiveness" or "dependability."

That is the big picture. Underlying it are smaller portraits of individual crises connecting them to particular institutional and legal circumstances. The common features present in these portraits can be summed up by observing that it is quite difficult, if not impossible, to give a coherent account of any single banking crisis anywhere without acknowledging a crucial role for some form of government interference or "legal restriction" in helping to make the crisis come about.[8]

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A "Legal Restrictions" Theory of Banking Crises

An alternative theory of crises, based on the last observation, would hold that banking crises are not free-market phenomena, but are rather consequences of government intervention in banking and currency systems.

Many kinds of "legal restrictions" have played a role in historical banking crises, so that it is not possible to treat all crises as having identical causes: unlike the conventional theory of crises, the "legal restrictions" theory proposed here is multicausal rather than unicausal. The conventional theory's unicausal view of crises is, indeed, one of its clear weaknesses. Unicausal explanations of complex though recurrent economic events may be elegant and neat, but they are often also simplistic and wrong. While the conventional theory of banking crises accounts only for a "typical" crisis that has no historical counterpart, the legal restrictions theory is really a collection of distinct explanations for particular crises—all of which, however, share a common basis in misguided government policies.

Although one cannot construct a "general theory" of banking crises based on legal restrictions, one can present a catalogue of legal restrictions, showing how each may help bring about a banking crisis and offering illustrations from the United States and elsewhere. George Benston and I have already offered partial catalogues, so I will not do more than summarize their contents here.[9] The kinds of legal restrictions that have made past banking crises possible are those that (1) increased individual banks' vulnerability to shocks of various kinds; (2) have themselves been sources of important shocks; (3) have created an environment conducive to "contagion" effects, so that individual bank failures are more likely to lead to systemwide runs; and (4) have obstructed private market mechanisms for avoiding or averting crises.

(1) Restrictions rendering banks more vulnerable to shocks include regulations artificially limiting banks' ability to diversify their assets and liabilities against relative price shocks. The most important examples of such restrictions are those artificially limiting the size of private banking firms, either by restricting branching or by limiting access to capital. Direct portfolio restrictions (like those once embodied in many bank charters) also limit diversification, exposing banks to unnecessary risks. Restrictions on in-

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terest rates like those once enforced by Regulation Q have exposed banks unnecessarily to interest-rate shocks.

Some legal restrictions increase individual banks' exposure to risk by actually subsidizing risky undertakings while allowing banks to reduce their own capital holdings. Examples of this include government deposit insurance and the presence of any lender of last resort willing to rescue insolvent banks.

(2) Among restrictions that provide a basis for shocks that would otherwise not occur, the most important are laws supporting discretionary money-supply management by central banks. These laws—including both legal tender laws that enable the issuance of fiat money, and legal restrictions on private note issuance—are the fundamental basis for major interest-rate and price-level swings which, according to Anna Schwartz,[10] have been the root causes of both past and recent waves of financial firm insolvencies.

(3) Restrictions have also made contagion effects more likely. As noted previously, contagion effects have been the exception rather than the rule in economic history. That in itself contradicts the conventional theory of banking crises. But there is more: where contagions have taken hold in the past, they too have been encouraged by government interference. For example, government-erected barriers to branch banking in the United States have sponsored the artificial growth of correspondent relationships among banks, making confidence in banks a function of confidence in their correspondents. Another, more widely practiced form of legal interference—interference with private note issuance—has obstructed an important "secondary" market for bank liabilities. This market might otherwise have served to price bank-specific risks efficiently, eliminating information asymmetries. Other forms of interference, including bank holidays and manipulations of the monetary standard, have also helped produce contagions of panic, as will be seen below in reviewing the crisis of 1933.

(4) Perhaps the worst way in which governments have helped expose banking systems to crises has been by interfering with banks' own devices for avoiding or otherwise dealing with such crises. By restricting private note issuance, governments have made it impossible for private banks to accommodate even routine changes in the demand for currency.[11] Governments have also prevented banks from undertaking "restrictions" of payments as a private means for coping with major shocks.[12] Finally, governments

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have artificially encouraged reliance on central bank lending in place of private interbank lending: all too often, central banks have functioned, not as lenders of last resort, but as lenders of *first* resort. This makes them appear more essential in rescuing illiquid but solvent banks than they really are. Central bankers are loath to pass up any opportunity to present themselves as white knights coming to the rescue of an illiquid private bank—the damsel in distress.

Of course, branching restrictions and other devices that discourage the development of large, private banks also undermine opportunities for private assistance, for the simple reason that it is much more difficult for a clearinghouse or other private bankers' "club" to put together a large emergency loan package that relies on many small banks than it is to put together a similar package involving fewer, large banks. Restrictions on mergers, finally, rule out other potential private rescue efforts, and thereby increase the likelihood of depositors suffering losses and staging runs.

The Role of Currency Monopoly

One legal restriction seldom discussed in the literature—the inability of private banks to issue their own notes—enhances the likelihood of banking crises in at least three important ways. First, it prevents banks from relying on their own resources to accommodate routine changes in the public's demand for currency. Second, it eliminates the secondary note market that could otherwise do away with information asymmetries in the market for bank money. Finally, monopolization of the supply of currency has been the basis for central banks' discretionary control of the stock of bank reserves. Through such control, central banks have been able to expand their own balance sheets recklessly, causing otherwise impossible gyrations in the price level, interest rates, and exchange rates—the most severe shocks to which private banks have ever been subjected.

That currency monopoly is the basis for central banks' discretionary manipulations of the money stock is, I trust, obvious enough: As long as all banks have equal rights to issue notes, none ever thinks of holding a rival's notes as reserves. Instead, rivals' notes are actively returned for redemption in some basic money. Historically, this was gold.

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The awarding of monopoly privileges in note issuance changes all this. Suddenly one bank becomes the system's sole source of convenient paper currency. Other banks begin to covet its notes, which (being, at first, still redeemable in gold) are in widespread demand. Soon these notes are being treated as a reserve in place of gold—which is, in turn, placed on deposit with the privileged bank. At this point the privileged bank no longer has to worry about its own issues being redeemed by rivals. Its sole concern becomes the balance of international gold payments, which eventually turns against it if it expands too much, as it is inevitably tempted to do. (Under free banking, in contrast, it is simply not possible to have a balance of payments crisis initiated by excessive domestic money creation.) But there is a way around the balance of payments constraint that limits even monopoly bank expansion under a gold standard: the suspension of gold payments. What no bank would have dared to do in a system in which all banks enjoyed equal rights is now done with impunity by the privileged bank of issue, thereby making its notes a fiat money, first temporarily, then for good.

The establishment of fiat money, in turn, means unlimited scope for a privileged bank to further abuse its powers in pursuit of narrow political and financial ends. Such was, broadly speaking, the history of the growth of central banks and fiat money throughout much of the world during the present century. This history has set the stage for price level, interest rate, and exchange rate movements such as were never seen under the gold standard. These fluctuations have spelled doom to thousands of private banks. The link between central banking and the abandonment of commodity money is particularly worth stressing, because so many past economists wrongly perceived central banks as devices for securing monetary stability. The evidence presented here suggests, on the contrary, that central banking is incompatible with monetary stability. Free banking grounded in strict rules of contract and bankruptcy law would have provided a much stronger bulwark against the flood of paper money.

One lesson in this is, to use the language of game theory, that the central banking "game" does not have a positive sum: the unique powers enjoyed by central banks have not been costlessly acquired. They are, rather, powers that would, under free-market circumstances, have been more widely shared among all private banks.

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The consequence of regulations concentrating these powers in a single, government-favored bank has been to make other banks weaklings dependent on central banks for their protection. Today, unfortunately, few observers (banking experts included) appreciate how the rise of central banking has served to weaken private banks.

The Banking Crisis of 1933

It is of course impossible, within the confines of a short article, to offer a "legal restrictions" theory of every historical banking crisis, or even of the forty-one crises listed in Table 1. I will attempt, however, to apply the theory to one important banking crisis, namely, the U.S. crisis of 1933. That crisis is particularly important because, of all crises, it best appears to fit the conventional view. That is not surprising as the conventional view was, to a large extent, shaped by the events of 1933.

The basic features of the crisis, consistent with the conventional view, were as follows. Large numbers of bank failures in the early 1930s triggered massive withdrawals of currency from the banking system which, in turn, led to the system's failure in March 1933. That failure might have been avoided had the Fed played the part of lender of last resort, either in the traditional manner (by making loans to solvent though illiquid banks), or by otherwise expanding the monetary base to compensate for changes in the currency-deposit ratio.

Whereas the conventional view blames government for failing to respond appropriately to the crisis, treating the crisis itself as originating in market conditions, the legal-restrictions approach identifies a more fundamental role of government interference. To begin, consider the large numbers of bank failures preceding the systemwide failure of March 1933. Although bank failures accelerated in the early 1930s, they had been common during the 1920s, when nearly 6000 U.S. banks failed. Most of the failures, both then and throughout the first two years of the Great Depression, were of small-unit banks in agricultural regions. These banks suffered from a decline in the relative price of agricultural products that predated the crash. Had the United States enjoyed nationwide branch banking, it might have avoided many or most of these relative-price-induced bank failures. Canada, which had branch banking, did

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avoid bank failures both before and after 1929, except for a single failure in 1923 involving fraud.

U.S. bank failures rose after 1929 in part because of an increase in the public's desired currency-to-deposit ratio, which tends to move inversely with changes in real income.[13] Had U.S. banks been free to issue their own notes, as Canadian banks still could, they might have accommodated much of this initial increase in the currency ratio by issuing more of their own notes in exchange for deposits. Indeed, national banks did manage to increase their note issues, from $691 million in February 1932 to $922 million in May 1933, thanks to a minor relaxation in otherwise binding note issuance restrictions.[14] This increase was, however, only a fraction of what was needed to accommodate the wants of the public. The remaining adjustment had to be provided through greater issues of Federal Reserve Notes and clearinghouse certificates and, in the absence of either, by means of a depletion of bank reserves.

Clearinghouse authorities in New York and elsewhere sought the Treasury's permission to issue clearinghouse certificates as substitutes for bank notes, as they had done during earlier crises. But they were refused permission on the grounds that such a private response was no longer needed: the Fed was capable of issuing "plenty of money that looks like real money."[15] In the event, of course, the Fed's response proved far from adequate.

Despite large numbers of bank failures, and legal restrictions precluding a secondary market in bank notes, bank runs prior to 1933 appear to have been confined to banks that either were insolvent before the runs or, owing to branching restrictions, were correspondents of insolvent banks. Even the dramatic run against the Bank of United States in December 1930 was not contagious.[16] Widespread panic did not become a feature of the U.S. banking crisis until February 1933, when it was provoked by two ill-conceived government policies. These policies were the state-declared bank holidays, commencing with Michigan's on February 14; and the federal government's plan to devalue the dollar, which became a subject of widespread rumors around the same time.

Bank holidays became a potent cause of contagion effects by encouraging currency withdrawals by depositors in nearby states, who feared the holidays themselves might spread. Holidays therefore exacerbated the very problem of bank runs they were intended to forestall.[17] Bank holidays were also unnecessary: as bankers

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urged at the time, mere "restrictions" of payments of reserve money, such as were undertaken during previous panics in 1893 and 1907, could have served the purpose of protecting banks' liquidity without closing the banks and thereby entirely depriving depositors and borrowers of access to funds.[18]

Rumors that gold would be devalued led to a run on the dollar, the burden of which was felt mainly by the Federal Reserve Bank of New York. According to Barry Wigmore, it was the Federal Reserve, rather than commercial banks, that needed and pleaded for a bank holiday, which was finally declared by New York's Governor Lehrman on March 4, precipitating the national bank holiday on March 6. Gold was, in fact, devalued soon afterwards. Although by the time of its accomplishment this devaluation may have appeared necessary as a means for restoring monetary stability, devaluation was certainly *not* necessary earlier in the year, when it was first proposed as a means of supporting the prices of farm commodities to placate the farm lobby.[19]

Other federal policies, including increased postal rates and a two-cent tax on checks, both adopted in mid-1932, also contributed to the banking crisis by encouraging public withdrawals of currency from the banking system. Such errors of commission, rather than the Federal Reserve's equally destructive errors of omission, warrant calling the crisis of 1933 a product of legal restrictions rather than a free-market phenomenon. This seems to be the case with banking crises in general.

NOTES

1. Henry C. Simons, *Economic Policy for a Free Society* (Chicago: University of Chicago Press, 1948); Lloyd W. Mints, *Monetary Policy for a Competitive Society* (New York: McGraw-Hill, 1950).
2. Several recent studies favor the real-shock or information-based view of crises over the "bubble" alternative. See, for example, Frederic S. Mishkin, "Asymmetric Information and Financial Crises: A Historical Perspective," in R. Glen Hubbard, ed., *Financial Markets and Financial Crises* (Chicago: University of Chicago Press, 1991), 69–108; and Charles W. Calomiris and Gary Gorton, "The Origins of Banking Panics: Models, Facts, and Bank Regulation," in ibid., 109–73.
3. See, for example, George Kaufman, "Bank Contagion: A Review of the Theory and Evidence," *Journal of Financial Services Research* 8, no. 2 (April 1994): 123–50.

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4. See Michael D. Bordo, "Financial Crises, Banking Crises, Stock Market Crashes and the Money Supply: Some International Evidence, 1870–1933," in Forrest Capie and Geoffrey E. Wood, eds., *Financial Crises and the World Banking System* (London: Macmillan, 1986), 190–248; and Anna J. Schwartz, "Financial Stability and the Federal Saftey Net," in William S. Haraf and Rose Marie Kushmeider, eds., *Restructuring Banking and Financial Services in America* (Washington: American Enterprise Institute, 1988), 34–62.
5. Kaufman, n3 above.
6. Kurt Schuler, "The World History of Free Banking: An Overview," in Kevin Dowd, ed., *The Experience of Free Banking* (London: Routledge, 1992), 7–47.
7. In most cases the major change marking the transition from free to unfree banking was the establishment of a central bank enjoying exclusive note-issue privileges.
8. This conclusion relies soles on readily available secondary accounts of the incidence of banking crises. Regrettably the extent of such evidence, especially for "free" banking systems, is quite limited. Ideally, one would want to have detailed survey evidence from a larger sample of both free and unfree systems. The conclusions reached here are, therefore, tentative ones. They do, nonetheless, at least attempt to come to grips with the evidence already at hand.
9. George Benston, "Does Bank Regulation Produce Stability? Lessons for the United States," in Forrest Capie and Geoffrey E. Woods, eds., *Unregulated Banking: Chaos or Order?* (London: Macmillan, 1991), 207–32; George Selgin, "Legal Restrictions, Financial Weakening, and the Lender of Last Resort," *Cato Journal* 9, no. 2 (Fall 1989): 429–59.
10. Schwartz, n4 above.
11. George Selgin, "Accommodating Changes in the Relative Demand for Currency: Free Banking vs. Central Banking," *Cato Journal* 6, no. 2 (Fall 1986): 617–34.
12. Hugh Rockoff, "Institutional Requirement for Stable Free Banking," *Cato Journal* 6, no. 2 (Fall 1986): 617–34.
13. Phillip Cagan, "The Demand for Currency Relative to Total Money Supply" *Journal of Political Economy* 66, no. 1 (August 1958): 303–28.
14. Benjamin Anderson, *Economics and the Public Welfare* (Indianapolis: Liberty Press, 1979), 289.
15. Helen M. Burns, *The American Banking Community and New Deal Banking Reforms, 1933–1935* (Westport, Conn.: Greenwood, 1974), 75.
16. Elmus Wicker, "A Reconsideration of the Banking Panic of 1930," *Journal of Economic History* 40, no. 3 (September 1980): 571–83.
17. George Benston et al., *Perspectives on Safe and Sound Banking* (Cambridge, Mass.: MIT Press, 1986), 52; E. C. Colt and N. S. Keith, *28 Days: A History of the Banking Crisis* (New York: Greenburg, 1933). Nevada was actually the first state to declare a banking holiday, in November 1932.
18. Gerald P. Dwyer, Jr. and R. Anton Gilbert, "Bank Runs and Private

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Remedies," Reserve Bank of St. Louis *Review* 71, no. 93 (May/June 1989): 43–61; see also Rockoff, n2 above. The success of restriction would have depended on banks' (or clearinghouses') ability to issue notes (or clearinghouse certificates) as substitutes for legal-tender currency and bond-based national bank notes. As noted, the Federal government refused to give banks or clearinghouses permission to issue such substitute currencies.

19. Barry A. Wigmore, "Was the Bank Holiday of 1933 Caused by a Run on the Dollar?" *Journal of Economic History* 47, no. 3 (September 1987): 739–55.

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Charles P. Kindleberger

THEORY VS. HISTORY: REPLY TO HORWITZ

Analysts such as Steven Horwitz, with strong prior beliefs, are seldom impressed by mere fact and tend to explain away empirical deviations from their theories. The belief that markets are moved only by fundamentals and not by occasional faddism and overshooting rests on the assumption that market participants form their opinions independently, when in fact they are from time to time driven by emulation. The belief that markets are rational and well-informed but government officials and central bankers incompetent is implausible on its face. The period since 1970 has seen bubble after bubble, some of which seemed likely to lead to financial crisis had it not been for the Federal Reserve.

In "Government Intervention: Source or Scourge of Monetary Order" (*Critical Review* 7, nos. 2–3), Steven Horwitz criticized my *Manias, Panics and Crashes: A History of Financial Crisis*[1] for its claim that market participants and the behavior of markets are sometimes irrational. There is a view that any attention to one's work, positive or negative, is welcome, especially in a world where the half-life of most ideas is, at a guess, three years and four months. The editor has asked me if I want to reply—perhaps dared me to—and after

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some consideration, and reading the daily press, I decided it would be pusillanimous not to.

Professor Horwitz, and I suspect many of the contributors to *Critical Review*, is (are) partial to rational expectations; to Austrian economic theory of the von Mises-Kirzner type; to free banking; to the beliefs that markets almost always zero in on equilibrium prizes; and to the notion that if not all market players are rational, informed, and independent of thought, enough are to make market outcomes efficient—were it not for the bungling of government. Most of them are too young to remember one Eric Hoffer, who, some years ago, wrote *The True Believer*, a book about people who acquire faith in an idea (a religion, a view of medicine, of government, of economics . . .) and are difficult to persuade otherwise.[2] Slightly more than a decade ago, Melvin Reder wrote a paper on "The Chicago School" (of economics), dwelling on its strong prior beliefs. If the facts do not bear out the theory, he wrote, members of the school are disposed to struggle for a protracted period, gathering more facts, dismissing the particular facts in question as outliers or exceptions, rejecting all facts, and so on, before they are willing to abandon, or even in some cases to modify, the theory in question.[3] An English economic historian, D. C. Coleman, wrote as an aside that economists are interested in theories, historians in evidence.[4] I choose not to argue polemically or otherwise with Horwitz on the theory, but will content myself with a few bits of evidence that have accumulated since the first edition of *Manias*; evidence which, in my judgment, supports the view that markets sometimes overshoot and fall back, and that in serious instances, a lender of last resort can help restore balance.

First, however, two words on the theory. Horwitz complains that I fail to distinguish among irrational participants in markets, irrational markets, irrational outcomes, error, and fraud. Unlike believers in the rationality of economic actors, I start with the view that a more fundamental human incentive is not increasing profit or utility, but emulation, mostly positive, sometimes in polarization. In this I get some support from Adam Smith, both in *The Theory of Moral Sentiments* and in *The Wealth of Nations*.[5] Among economists, some pattern their thought after monetarists, some after one or another brand of Keynesianism, some on other faiths. The rational expectations notion that market participants are intelligent, informed, and arrive at their strategies *independently* (empha-

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sis mine) is hard to support on the evidence, which see below. Some leaders do, but leaders have followers. And some followers follow more or less blindly.

As to whether individuals are rational, but markets may not be, consider the fallacy of composition. I offer the paradigm of a fire in a theater or nightclub. The theater program says "In case of fire, walk, do not run, to the nearest marked exit." If others walk, it could be regarded as rational to run. If all run, the outcome is irrational. Horwitz fails to note that I cite panics started by the cry "*Sauve qui peut*" or "*Die Letzen beissen die Hunde*" (the dogs bite those at the back). Rational people can produce irrational outcomes, as the prisoners' dilemma testifies.

As to error and fraud: errors are not a problem unless they occur en masse and pile up in emulation. Fraud is more interesting. Horwitz dismisses fraud by saying that government should suppress it. Government, in his view, is incapable of doing much else well; it is surprising that it should succeed in this arcane field. Economic historians have discovered that honesty pays in repeated dealings among equals, where reputation counts.[6] But transactions are not always between or among peers. Not all participants are equally sophisticated and honest. Widows and orphans are the canonical example of classes that need to be protected from dishonest purveyors of the wrong types of investments, insurance, products, medicine (e.g., snake oil). I suggested that fraud and swindles follow a cyclical pattern, rising as asset prices rise as the naïve see their neighbors getting rich and succumb to the blandishments of the unscrupulous; and rising again, after a relapse from the bubble bursting, as overleveraged speculators, facing bankruptcy, try, like Ivar Kruger and Clarence Hatry, to gain liquidity by stealing it.

Let me stipulate, as lawyers say, that virtually all, but not all, market participants are informed, intelligent, rational, and honest, though they may sometimes be carried away by a fad. I have a hard time, however, in agreeing with the true believers in free banking that central bankers invariably get things wrong. Public-choice theorists who regard all bureaucrats (in public offices, but not in private corporations) as time-servers, interested in leisure, income, rights but not duties, seem to me to have failed to encounter a random sample of the breed. When economic life proceeds smoothly, there is doubtless pressure for energetic men and women to leave the calm waters of government for the more tempestuous

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private life. But in times of excitement—the New Deal, wartime, postwar, or in bodies that continuously face difficult decisions (the active commissions, the higher courts, and, indeed, the central banks), the notion that public servants are incompetent is implausible on its face, and has to be rejected by fair-minded people.

But let me get to economic history. It is bizarre that students—years, decades, centuries later—will claim that incidents that people at the time regarded as manias or bubbles were in fact rational market responses to events or to bad public policy. "Revealed preference" may not enjoy universal acceptance as a theory of consumption, but historically revealed preferences for particular interpretations seem to me to push the burden of proof onto those disagreeing. I cite the tulip mania of the 1630s, the canal mania of the 1790s, railway mania of 1847; the South Sea and Mississippi bubbles, where the infection of London by disease in Paris could not be more apparent; and to bring matters up to date, the Japanese Nikkei share index and real-estate bubble of 1988–89 and bust in 1990–91. I should add that I find absurd the Mendelian defense of fundamentals in the tulip "bubble"—that the breeding of rare variants is difficult.[7] In an example I have used before, I assert that engraving the Lord's prayer on the head of a pin is an excruciatingly difficult trick, but one that yields an output with no great price. Supply alone does not determine price, but both blades of Marshall's scissors—supply and demand. And demand may be produced by noise traders, by people emulating presumably rational lemmings, Gadarene swine, or sharks in a feeding frenzy.

The Japanese bubble is up to date.[8] Let me list as well a number of incidents in the United States of late which give my book some slight claim to prescience, incidents that look to me manic, or like bubbles, and may indeed have been bubbles: in the 1970s REITs (Real Estate Investment Trusts); Third World debt from 1973 to 1982; gold, which rose from $42 per ounce in 1971 to $780 before settling in the $350 to $400 range; conglomerates; in the 1980s and 1990s, condominiums, shopping malls, hotels, office buildings, S&Ls, takeovers (both friendly and hostile), junk bonds, collectibles (especially van Gogh paintings, but not Gainsborough), IPOs (initial public offerings), mutual funds specialized in emerging markets (especially Asia and Latin America), commodity speculation (in which at least one player earned a return of $100,000 on an initial capital of $1000 in eleven months), foreign exchange (in which one

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hedge fund made a profit of $1 billion—in some accounts, $1.5 billion—in 1992, and lost $600 million in early 1994, and in which another went bankrupt with a loss of $600 millions of investors' funds), and highly leveraged gambling in bonds backed by home mortgages.[9] To blame this last case on central-bank incompetence, when the Federal Reserve Open Market Committee carefully, and after long deliberation, raised the federal funds rate from 3.25 to 3.5 percent, calls for enormous imagination.

A theorist may want to sort out this list of incidents to decide among rational or bewitched participants, outcomes, markets, fraud, error, government mistakes of policy, and the like. I am content to assert that market participants occasionally—by no means always—get the bit in their teeth and run away in what might loosely be called manic fashion, frequently until they come a cropper. Sometimes that outcome is avoided by superior central-bank policy: Paul Volcker and Andrew Brimmer rescuing Bache & Company when Bunker Hunt's bankruptcy, caused by a misguided attempt to corner the silver market, threatened chaos; Gerald Corrigan of the New York Fed and Alan Greenspan pumping liquidity into the market on Black Monday, October 19, 1987. There are problems with the lender-of-last-resort role: moral hazard, agonizing decisions over when banks are too big to fail while letting the little banks drown. It is not simple. Those who believe it is may get satisfaction from their self-confidence. I doubt that they greatly advance scholarship.

NOTES

1. Charles P. Kindleberger, *Manias, Panics and Crashes, A History of Financial Crisis*, rev. ed. (New York: Basic Books, 1989).
2. Eric Hoffer, *The True Believer: Thoughts on the Nature of Mass Movements* (New York: Harper-Collins, 1988).
3. Melvin Reder, "The Chicago School," *Journal of Economic Literature* 20, no. 1 (March 1982): 1–30.
4. D. C. Coleman, "Introduction" to idem, ed., *Revisions in Mercantilism* (London: Methuen, 1965), 8.
5. Adam Smith, *The Theory of Moral Sentiments*, 11th ed. (Edinburgh: Bell & Bradfute, 1808), vol. 1, 143–45; idem, *An Inquiry into the Wealth of Nations* (New York: Modern Library, 1937), 71.
6. Avner Greif, "Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders," *Journal of Economic History* 49, no. 4 (December 1989):

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857–82. For a dissenting voice, see Pier Luigi Sacco, "On the Fragility of Reputational Equilibria under Systematic Uncertainty: What is Wrong with Rational Expectations," Banca Nazionale del Lavoro *Quarterly Review* no. 179 (December 1990): 459–74.

7. Peter M. Garber, "The Dollar as a Bubble," in Stefan Gerlach and Peter A. Petri, eds., *The Economics of the Dollar Cycle* (Cambridge, Mass.: MIT Press, 19??), 125–47.
8. Christopher Wood, *The Bubble Economy: Japan's Extraordinary Boom in the 1980s and Bust in the 1990s* (New York: Atlantic Monthly Press, 1992).
9. Floyd Norris, "A Speculator Collapses, and Traders Worry," *New York Times*, April 3, 1994: D1.

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Steven Horwitz

SYSTEMIC RATIONALITY AND THE EFFECTS OF FINANCIAL REGULATION: REJOINDER TO KINDLEBERGER

In his Reply, Kindleberger falsely ascribes to me the views that political actors are utterly incompetent, while market actors are completely rational; and that political processes are pure chaos, while market processes are perfectly efficient. My point was that the relatively better performance of the market is a result of systemic factors, not the rationality of individuals. Kindleberger fails to address the historical evidence indicating the comparatively poor performance of government intervention in the monetary order. "Market manias" are, in fact, largely the product of ill-conceived government regulations.

In his Reply ("Theory vs. History: Reply to Horwitz," *Critical Review* 8, no. 4) to my review of his *Manias, Panics, and Crashes*,[1] Charles Kindleberger takes issue with what he sees as my attempt to portray market actors as models of rationality, and government bureaucrats as bungling incompetents. Had I in fact made such an argument, I would agree that a rebuttal is in order. However, a careful reading of my review essay will show that in reality, I contended that differences in rationality or competence among individuals *cannot* explain the differences in performance between market and political processes. The point of my critique of central banking and financial regulation was that the record demonstrates

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the futility of asking central bankers and regulators to second-guess the market, because political processes are inferior to market processes in generating the knowledge and incentives needed to cultivate "rational" action. Bureaucrats are no less competent than entrepreneurs; they simply do not have sufficient signals indicating to them the right things to do. The historical evidence in my review essay, which Kindleberger chose not to address directly, was intended to illustrate this argument.

Kindleberger claims that I assume rational actors make their decisions independently of one another, leaving no room for the important factor of emulation. On the contrary, I agree that emulation is a crucial part of many social processes. Where I suspect we differ is over whether emulation is a positive or a negative force. Certainly market actors might be led down the primrose path by faulty judgments about who or what to emulate, but this might happen in political processes as well. The advantage of markets is that they can provide both signals and incentives to help correct emulation-driven error, while analogous signals are weak or nonexistent in political processes. I am much more fearful of the emulation of error in political decision-making, which can simultaneously affect every member of a polity at once, than in markets, where the effects of genuine market errors (as opposed to problems such as inflation or business cycles, which are generated by political intervention) are normally more localized and where corrective incentives are stronger.[2]

The bottom line for Kindleberger is that opponents of central banking treat bureaucrats as completely incompetent and market actors as completely rational. But I did not argue, as Kindleberger implies, that bureaucrats *always* get it wrong and markets *always* get it right. Nor did I contend that bureaucrats are any more self-interested, stupid, or lazy than anyone else. I concur, for instance, with Kindleberger's judgment about the role of the Fed in the 1987 stock market plunge. If the Fed's responsibility is to provide liquidity, then it performed up to par in that instance. I suggested, however, that in general and over time, the mistakes of central banking significantly outnumber the victories because of the relative *systemic* inability of the political process to inform and encourage economically appropriate activity.

Political actors may attempt to act in the public interest. Yet when faced with concrete circumstances of choice, determining the

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public interest often becomes impossible, as does deciding which specific actions will serve that end. Central bankers, and the drafters of government regulations designed to enable the money supply to adjust to changes in money demand, have often found the task extremely difficult. In my review I attempted to illustrate this by pointing to the regulations of the so-called "free banking era" in the antebellum U.S., as well as those of the National Banking System that followed it, as sources of monetary instability throughout the nineteenth century. In addition, the limitations on nationwide branch banking that persisted through the twentieth century, and the Fed's inaction in the face of dramatic changes in money demand in the early 1930s, contributed significantly to the Great Depression and the almost 6000 bank failures that occurred in that period. More recently, the limits on branching, combined with the risk-enhancing incentives of federal deposit insurance, have led to a new round of bank failures. Meanwhile, the increasing complexity of the money market, combined with the political incentives for debt-reducing monetary policies, led to the inflation of the 1970s and have created fears of rekindled inflation today. It is unfortunate that Kindleberger appears to have nothing to say against any of this empirical evidence of the problems with political control of the monetary order.

In contrast to governments, markets have prices and profits to serve as knowledge surrogates to guide the actions of producers and consumers. The same person who, placed in the political process, finds rational action difficult, will, in the market, tend to find rational action easier because markets as institutions assist in making economically appropriate choices. Thus, I argued, there have been a number of ways in which bankers and others in the market have solved problems without the need of government intervention. Before government deposit insurance, banks used advertising to show depositors the quality of bank portfolios. Profit-seeking clearing houses performed the desirable functions of lenders of last resort without falling into the trap of overproducing money or creating moral hazard problems. Clearing houses also made use of the print media to prevent bank failures and currency shortages from spreading. Finally, banks developed new instruments, such as the option clause, to avoid devastating bank runs without government intervention.

Kindleberger ignores these facts, which suggest that the case

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against political intervention in the monetary order is not that the interveners are either evil or stupid people, but that their ability to make rational decisions suffers to the extent that they lack access to market signals.[3] Political actors may *then* tend to become self-serving because they have no way of knowing what to do in order to serve the public interest. That is not a sign of mendacity or stupidity, but of government biting off more than it can chew.

Kindleberger does, however, raise empirical evidence of his own. First, he points to "maniacal" swings in the price of gold. It is true that gold prices have become less stable in recent years, but Kindleberger gives us no hint as to the reason. The price of gold moves in step with both actual and expected rates of inflation, which themselves are largely the result of the poor performance of central banks. It is not coincidental that swings in the price of gold have increased as both the level of, and the variation in, the inflation rate have increased in the last thirty years. Many investors use gold as a hedge against inflation; swings in its price may be rational responses to inconsistent Federal Reserve policies that force constant revisions in the inflationary expectations that underlie decisions to purchase gold.

Other examples of manias cited by Kindleberger include the savings and loan crisis, the takeover binge, junk bonds, and real estate investment instability. In all of these cases, the activities of government regulators or central bankers have created incentives to engage in risky or speculative behavior.

For example, the savings and loan crisis may be attributed to the combination of three different government interventions. First, the inflation of the late 1960s and early 1970s created a severe problem for savings and loans that were locked into long-term mortgage loans at fixed interest rates. When the Fed generated inflation, the real return on those loans fell, while, in order to attract new funds, savings and loans had to pay depositors even higher rates of interest to compensate for the effects of inflation. As a result of falling earnings on loans, higher interest payments on deposits, and funds lost to competitors, numerous savings and loans began to lose money through the 1970s.[4]

Second, savings and loans were, like banks, limited in their ability to cross state lines, leaving their asset portfolios vulnerable to the fate of local economies. Critics who blame the S & L crisis on unfettered capitalism need to explain why the crisis occurred dis-

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proportionately in Texas and Oklahoma—states that were hit hard by the decline in oil prices during the mid-1980s. Local savings and loans (and commercial banks) had lent heavily to oil-related enterprises because they were not allowed to diversify geographically. As oil-related firms hit hard times, so did the banks to which they were in debt.

Third, increased federal deposit insurance coverage gave savings and loans an even greater incentive to engage in risky behavior. If they were successful, they reaped the benefits; if they were not, the FSLIC (before it went bankrupt) would bail out their depositors. The savings and loan crisis was the result of broadly rational actions within an irrational regulatory regime.[5]

A good portion of the takeover "binge" of the 1980s can be ascribed to changes in corporate tax laws that favored debt over equity. Corporations found that going into debt to buy out other firms was a financially prudent strategy, given the tax treatment of the options they faced; hence the phenomenon of leveraged buyouts. To the extent that such takeovers and mergers were mistakes, we would expect market signals to indicate it, and, in fact, many of the large conglomerates formed during the 1980s are now being broken up, as investors and managers have discovered that they were unable to make large, frequently overly diversified, corporations profitable. On the other hand, there appear to be no objective grounds to refer to the 1980s takeovers as a "binge." How does Kindleberger, or anyone else, presume to know when "too many" takeovers have taken place, not to mention which takeovers we should include among the "too many"? The historical record of attempts at centralized economic planning suggests that political actors are not likely to be more successful than markets at picking winners or avoiding losers.[6]

The junk bond market and the real estate boom and bust can be addressed simultaneously. So-called junk bonds are simply bonds that promised high rates of return but also involved higher levels of risk. Such bonds were used to try to secure financing for various projects in the 1980s, and continue to do so today. Sometimes they financed takeovers, sometimes they helped finance new firms, and sometimes they were used to restructure the financing of existing firms. Junk bonds had some successes and some failures, as we would expect from any financial instrument. When they failed, the

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losers were those who chose to accept the risk for the higher rate of return.

Why the charge of "mania" here? In many people's eyes, junk bonds were intertwined with the savings and loan crisis. But the facts are otherwise. As financial industry analyst Bert Ely has shown, junk bonds made up only about 2 percent of S & L loan losses in the 1980s.[7] Whatever their merits or demerits, then, junk bonds can hardly be blamed for the S & L crisis. Like many apparently strange financial innovations, junk bonds were victims of the attention paid to their failures, and inattention to their successes.[8] The current debate over "derivatives" is playing out in much the same way.

Where savings and loans did invest disproportionately was in real estate, not junk bonds. As a result of the Garn-St Germain Act in 1982, savings and loans were allowed to invest in assets other than residential mortgages. Taken by itself, this enabled savings and loans to diversify so as to avoid the problems that inflation had created for their mortgage portfolios. The problem, however, was that Congress simultaneously raised deposit insurance coverage to $100,000, giving S & Ls the green light to speculate in real estate, knowing that their depositors would be bailed out if their gambles did not pay off. In addition, changes in the tax laws increased the relative desirability of real estate compared to other investments (due to changes in the way depreciation was accounted for). These factors together led to the real estate boom, and the eventual failure of some savings and loans led to a downward correction in real estate values, leading to more failures as the value of other S & Ls' real estate holdings fell.

Ely indicates that real estate losses were the largest element of S & L losses after 1982. Almost half of the losses S & Ls incurred in the 1980s, however, occurred before 1983—that is, before deregulation had an impact. These losses can be ascribed to the inflation-generated problems of the late 1970s.[9] To refer to the real estate boom and bust (or the S & L crisis) as purely market-driven manias is not consistent with the historical evidence.

Despite his attempt to claim the high ground of empiricism, Kindleberger's Reply neither addresses the historical claims made in my original review essay, nor adequately documents the interpretation of the historical episodes it cites. Rather than assuming that voters, legislators, and regulators are completely incompetent

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while consumers and entrepreneurs are perfectly rational, I attempted to explore more deeply the incidents Kindleberger claimed were examples of market irrationality to see whether they could instead be seen as rational responses to the incentives created by mistaken government intervention.

Attempts to interpret the history of market economies need to start by recognizing that such economies are now, and always have been, permeated by government intervention. Thus, the historian needs to be extremely careful not to automatically treat every economic difficulty as an instance of market failure, rather than as an unintended consequence of government interventions already in place. This possibility is overlooked by Kindleberger's book and is far too quickly dismissed by his Reply.

NOTES

1. Charles Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises*, rev. ed. (New York: Basic Books, 1989).
2. Beyond this, emulation is a crucial component of the spontaneous ordering processes that constitute markets. For example, one important function of profit is to signal where resources are being used valuably so that others can emulate the behavior and in so doing better serve consumers. Consider too the role of emulation in the origins of money, law, and morality. To have a generally accepted social institution, imitation processes must take place.
3. "The entrepreneur's commercial attitude [i.e., rationality] and activity arises from his position in the economic process and is lost with its disappearance." Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth," in F. A. Hayek, ed., *Collectivist Economic Planning* (Clifton, N.J.: Augustus M. Kelley, 1975), 120.
4. See Catherine England, "The Savings and Loan Debacle," *Critical Review* 7, nos. 2–3 (Spring-Summer 1993): 307–19; and Lawrence H. White, "What Has Been Breaking U.S. Banks?" ibid., 321–334.
5. On these issues see several of the essays in Catherine England and Thomas Huertas, eds., *The Financial Services Revolution* (Boston: Kluwer, 1988), especially Gerald P. O'Driscoll's "Deposit Insurance in Theory and Practice," 165–79.
6. See the statistics on the performance of various "planned" economies contained in Janos Kornai, *The Socialist System: The Political Economy of Communism* (Princeton: Princeton University Press, 1992).
7. See *The Wall Street Journal*, July 20, 1990: A2 for a summary of Ely's findings.
8. See Glenn Yago, "Ownership Change, Capital Access, and Economic Growth," *Critical Review* 7, nos. 2–3 (Spring-Summer 1993): 205–24.
9. See Ely.

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Cass R. Sunstein

ON COSTS, BENEFITS, AND REGULATORY SUCCESS: REPLY TO CRANDALL

Robert Crandall writes as if the regulatory state is a simple failure. In fact, however, from the economic point of view there have been many successes, in the form of regulations whose benefits exceed their costs. Moreover, economic criteria are inadequate for evaluating regulatory performance, since even well-aggregated private willingness to pay provides a poor basis for assessing government regulation. It is now necessary to move beyond sterile debates about whether regulation is desirable; nonregulation is not an option, since laissez faire is itself a regulatory system. Democratic, economic, and constitutional criteria hold out the promise of much better regulatory tools, in the form of flexible incentives rather than rigid commands.

Good economists have contributed an enormous amount to the study of law, but sometimes good economists are bad readers, because they read everything as if it were economics. Sometimes good economists read philosophy badly, because they treat philosophy as a branch of economics (usually game theory). Sometimes good economists read novels badly, because they treat literature as a branch of economics (usually experimental economics, filled with preference reversals, problems of intransitivity, and other anomalies). Sometimes good economists read law badly, too.

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I don't know that Robert Crandall, an especially good economist, has read *After the Rights Revolution*[1] badly, but I do think that his review essay, "Regulation and the 'Rights' Revolution: Can (Should) We Rescue the New Deal?" (*Critical Review* 7, nos. 2–3), treats the book as a cost-benefit analysis of the regulatory state, when that is at best only a small part of its goal. Mostly the book tries to explore what can be said, at the theoretical level, on behalf of the rejection of common law principles of market ordering, and also to see how the current U.S. regulatory framework might be made more consistent with our constitutional heritage.

Thus I urge, above all, that there is a substantial difference between consumer preferences and democratic judgments. Consumer preferences should hardly be identified with liberty. They are based on the criterion of private willingness to pay, which is not the same as utility, and which may diverge from the more considered convictions that ought to and sometimes do play a role in politics. Consumer preferences, often based on inadequate information and manifested through private willingness to pay, are at best an incomplete foundation for regulatory policy. Private preferences, as they are expressed in the market domain, are an inadequate foundation for regulation in a constitutional democracy. Such preferences may be adaptive to an unjust status quo or may otherwise be products of distortion.[2] Consumer sovereignty is a fine ideal, with many useful applications, but it is hardly an appealing basis for a democracy. Our system prizes deliberative democracy, not aggregated willingness to pay.

Moreover, there is nothing sacrosanct about existing entitlements, which owe their origins not to nature but to law. The notion of "laissez faire" is a gross misdescription of free markets, which cannot exist without a range of (coercive) legal rules. (The dependence of free markets upon law is a lesson that Eastern Europeans are learning all too well.) Free markets should be taken not as axiomatic or natural, but as political practices to be evaluated pragmatically, in terms of their effects (often beneficial, sometimes harmful) on the human beings who live with them.

Nor does any sound understanding of liberty stand in the way of many regulatory initiatives, which can solve collective action problems, reflect democratic judgments, or overcome problems in information and preference formation.

I urge as well that the U.S. Constitution does not invalidate the

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regulatory state, and that, in principle, many regulatory initiatives are fully consistent with our founding aspirations. On the other hand, some of our constitutional goals are in considerable tension with modern regulatory practices. Crandall is quite wrong to say that my "only reform" involves judicial interpretation.[3] On the contrary, I suggest a wide range of structural and substantive changes, in the interest of constitutional, democratic, and economic goals.[4]

Thus we should increase presidential control over the regulatory process, so as to promote accountability and uniformity in execution of the laws—two defining constitutional commitments. We might also create a regulatory budget, so as to draw attention to the real-world effects of regulation and in this way increase legislative accountability and deliberation. We should also shift from congressional specification of technological "means" (what kind of device best reduces automobile pollution?) to congressional identification of basic ends (how much pollution reduction, and at what price?). Specification of means is a way to avoid democratic deliberation on the important issue, and to leave things in a kind of technocratic fog. Attention to means is, for this reason, inconsistent with the original constitutional aspiration to deliberative government.

Most important, American government ought to move away from its damaging enthusiasm for command-and-control regulation. This form of regulation increases the risk of factional influence over government, and factional influence is a core target of the constitutional structure.

Instead of command and control, new initiatives should stress three possibilities, all of which take the form of *privately adaptable rules*, as opposed to rules that specify end-states. The first is economic incentives—emission-trading rights and taxes and fines, rather than rigid government mandates. Economic incentives reduce interest-group power and also focus legislative deliberation on the right questions. The second possibility is informational remedies for risk, in which people are told about dangers, and allowed to respond as they see fit. Through providing information, or requiring disclosure from employers or sellers, government can fortify both markets and democratic processes. The third possibility is decentralized approaches, which allow greater flexibility at the state and local level, and thus connect with the founding commitment to federalism. These substitutes for command-and-control

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regulation promise to make things better, not only in economic terms, but also from the constitutional point of view.

Of course, most important regulatory reforms must come from nonjudicial institutions. Crandall misdescribes my position on this point for, as I emphasize, legislative and executive reforms are critical, and judicial approaches secondary.[5] But courts have to interpret regulatory statutes; therefore, judicial interpretation will inevitably be an important part of the modern regulatory state. I spend a lot of time on judicial interpretation because that topic is an unmistakable ingredient in regulatory performance (if a comparatively small one), because it has independent theoretical interest, and because it is important for all citizens, albeit especially for lawyers.

My basic point is simple: Judicial interpretation of regulatory statutes should be designed to make regulation better rather than worse—where "better" is understood especially from the constitutional point of view, but also from the standpoint of democratic and economic theory. I suggest that interpretive principles should be built from a good understanding of the constitutional backdrop, as well as from an understanding of how regulation characteristically goes wrong. It is for this reason that I urge a number of "interpretive principles" to be used in cases of statutory ambiguity. These principles include, for example, the rule of law, proportionality between costs and benefits, political accountability, the exemption of *de minimis* risks, and the illegitimacy of retroactive regulations.

I do not know if Crandall disagrees with any of these principles. I do not know if he disagrees with what I say about foundational issues and the constitutional backdrop. I am left wondering what he thinks about the foundations of regulation, democratic theory, constitutional law, structural change, substantive reform, and judicial interpretation.

Now a few words on what Crandall does say. Though he writes little about judicial interpretation, he appears critical of the idea that courts should construe ambiguous statutes so as to forbid measures whose costs are disproportionate to their benefits. In view of his general enthusiasm for cost-benefit analysis, I am surprised; I would have expected Crandall to like this principle of interpretation. Apparently he does not, citing legislative "intention" and legislative "pressure." Crandall thinks that "intention" and "pressure"

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indicate legislative skepticism about cost-benefit balancing. To be sure, Congress often seems unenthusiastic about cost-benefit analysis; here I agree with Crandall. But legislative skepticism about cost-benefit balancing—whatever notions like "legislative skepticism" may mean, given the difficulties of analyzing the motivations of a multimember body—has no necessary bearing on judicial interpretation unless the skepticism is explicitly expressed in law, which is the constitutionally specified vehicle by which Congress makes its will known. To figure out the relation between "legislative skepticism" and judicial interpretation, we need a normative theory of some kind.

Of course it is highly controversial to say what Crandall apparently takes for granted: that legislative "intentions" and "pressure" should be used in judicial interpretation at all. Many people are doubtful about judicial use of legislative "intentions," partly because of the murkiness of the concept, partly for constitutional reasons. Under the Constitution, Congress enacts laws, not its intentions about what laws mean. It is the law that is binding, not the unenacted intentions.

From the simple fact that Congress "intended" to do something, *nothing at all must follow for the practice of legal interpretation.* (Economists interested in legal decisions often miss this point.) What matters, on one possible view, is what Congress says, not what it intends. In any case, we cannot base a normative theory of interpretation on a descriptive theory of legislative "intention" or even on a positive theory of legislative behavior. To come up with a normative theory, we have to make some normative claims. I do not think that it is possible to generate a plausible normative theory that grounds judicial interpretation entirely on legislative "intentions," much less on interest-group theories of politics. Much of *After the Rights Revolution* discusses this complex issue of interpretive theory, explains my doubts on this score, and supports an alternative view.

Crandall complains that the interpretive principles I endorse would be too baroque. Maybe they would be; this is an important matter. But Crandall has said nothing about his own understanding of statutory interpretation, and I do not think that it is easy to set out a theory of legal interpretation that is not baroque in just the way that Crandall understands that term. Perhaps Crandall thinks that courts should simply follow statutory text and "intent," but

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these notions are far from simple, and they hardly eliminate the complexity of the task of interpretation. Text and intent are often indeterminate, and when they are, courts need some external interpretive principles to decide cases. We cannot decide cases without such interpretive principles, and we may as well have principles that grow out of an understanding of the constitutional backdrop, and of both the aspirations and failures of the regulatory state.

So much for the constitutional backdrop, interpretive theory, and policy reforms. I am especially interested to see Crandall's views on the real-world effects of regulation. Here economists are specialists, and Crandall is especially good on this topic. But I think Crandall has misstated my views, and also described the underlying facts too bluntly.

Begin with an area that is most important to federal regulation, that plays a large role in my book, and that Crandall does not discuss—laws and regulations forbidding discrimination on the basis of race and sex. The most important initiative—the Voting Rights Act of 1965—appears to have broken up the white monopoly on electoral processes in a number of states. Only two years after passage of the Act, the number of registered blacks in the eleven southern states increased from 1.5 million to 2.8 million—an increase of nearly 90 percent. This is an impressive illustration of regulatory success.

Turn away now from voting rights and toward discrimination in general. Though the evidence is more disputed, the better view is that the Civil Rights Act of 1964 has also had important beneficial consequences. The most careful and impressive study shows that the Act had major effects on the manufacturing sector in South Carolina. "Suddenly in 1965 the black share in employment begins to improve when Title VII legislation becomes effective and the Equal Employment Opportunity Commission begins to press textile firms to employ blacks and when Executive Order 11246 forbids discrimination by government contractors at the risk of forfeit of government business."[6] Many other studies reach a broadly similar conclusion: that the federal effort to redress race and sex discrimination has had many favorable consequences.[7]

Turn now to the issue of safety and health, issues of special concern to Crandall. Perhaps lawyers read economists badly, too, but Crandall's own illuminating work shows significant gains to life and limb as a result of government regulation of automobiles.[8]

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Crandall also demonstrates gains in the context of air pollution.[9] I do not think that a fair-minded reading of Crandall's impressive books on regulation could yield the undifferentiated kind of skepticism that Crandall's review essay suggests. Crandall offers many suggestions for making things better (to his lasting credit!); his books are hardly a celebration of the regulatory status quo. But they suggest that in many ways, regulation has made automobiles safer, and it has helped make the air cleaner.

Consider the related issue of occupational risk. W. Kip Viscusi, one of the best and most vigorous critics of federal regulations, has recently found that OSHA's infamous cotton dust standard may be a success story. Viscusi writes, "The standard is having a considerable impact. Data on the relationship between exposure doses and disease incidence, as well as the fragmentary illness data and the evidence based on worker turnover, suggest that the risks of byssinosis have been reduced dramatically."[10] Viscusi does not contend that the standard survives cost-benefit balancing—though he does insist that many regulations do, on which more below—but he does conclude that it "has proven to be much more cost-effective than was anticipated originally, in large part because the costs of compliance were greatly exaggerated."[11]

Now put Crandall and particular programs to one side, and turn to the performance of the regulatory state in general. Of course I do not suggest that government regulation in its current form passes a global cost-benefit test. There is much indeterminacy in the data, and certainly many regulatory efforts have been futile, self-defeating, counterproductive, or much worse. (In fact this is one of the principal points of my book, contrary to the impression left by Crandall.) But we know enough to say that a number of regulations have made things better. Despite the range of factual uncertainties, *all detailed cost-benefit analyses of regulation—including John Morrall's, cited by Crandall—support just this point.*[12] Every detailed study shows a number of regulations that have saved lives at comparatively low cost.

Consider, for example, Viscusi's recent discussion, based on Morrall's recent updating of his own now-dated study. Viscusi's discussion shows that thirteen of the most important federal regulations *pass* a cost-benefit test.[13] These include OSHA's hazard communication regulation, saving 200 lives per year; the Consumer Product Safety Commission's unvented space heaters regulation,

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saving over 60 lives per year; the Federal Aviation Administration's seat cushion flammability regulation, saving 37 lives per year; OSHA's oil and gas well service regulation, saving 50 lives per year; and the National Highway Traffic Safety Administration's passive restraints/belts regulation, saving no fewer than 1,850 lives per year. It should not be necessary to emphasize that these are high numbers of deaths averted, and that the comparatively low cost of regulation in each case, shown in Viscusi's figures, reveals substantial regulatory successes.

There is considerable dispute about how much we should spend to save a statistical life. Probably no single number would make sense; the appropriate expenditure depends on a range of contextual matters, including the voluntariness of subjection to the risk, the distribution of the risk, the catastrophic nature of the accident, and much more. For this reason cost per life saved is an incomplete guide to regulatory problems. But even among skeptics about government regulation and enthusiasts for calculations of cost per live saved, there is broad agreement that an expenditure of $5 million dollars or less per life saved is at least a reasonable place to start. Consider in this regard the good results shown in Table 1.

Now it may be the case that the $5 million amount is too crude even as a starting point. Perhaps no general starting point makes sense; or perhaps we should begin with a somewhat lower figure. Perhaps some of the figures above are mistaken. Certainly there is much uncertainty and guesswork here. But my central point is this: However the contested issues may be resolved, this table suggests that a number of regulations are saving lives, and doing so at comparatively low cost. It will not do to emphasize what is undoubtedly true, that some of these numbers depend on speculative assumptions. We have reason to believe that much regulation is justified; certainty cannot be expected in these matters.

In light of all this, I do not think that Crandall's across-the-board pessimism about regulation is justified by what we know. Undoubtedly my own presentation in *After the Rights Revolution* needs updating, correction, clarification, and qualification, and I am grateful for Crandall's review on this score. But I think that Crandall's broad pronouncements are somewhat incautious, and not adequately justified by the facts.

Nor does *After the Rights Revolution* neglect the problem of regulatory failure. It tries to give a sense of the numerous failures, many

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Table 1: Cost-Effectiveness of Selected Regulations

Regulation	Agency	Cost per premature death averted ($ millions 1990)
Unvented Space Heater Ban	CPSC	0.1
Aircraft Cabin Fire Protection Standard	FAA	0.1
Auto Passive Restraint/Seat Belt Standards	NHTSA	0.1
Steering Column Protection Standard	NHTSA	0.1
Underground Construction Standards	OSHA-S	0.1
Trihalomethane Drinking Water Standards	EPA	0.2
Aircraft Seat Cushion Flammability Standard	FAA	0.4
Alcohol and Drug Control Standards	FRA	0.4
Auto Fuel-System Integrity Standard	NHTSA	0.4
Standards for Servicing Auto Wheel Rims	OSHA-S	0.4
Aircraft Floor Emergency Lighting Standard	FAA	0.6
Concrete & Masonry Construction Standards	OSHA-S	0.6
Crane Suspended Personnel Platform Standard	OSHA-S	0.7
Passive Restraints for Trucks & Buses (Proposed)	NHTSA	0.7
Side-Impact Standards for Autos (Dynamic)	NHTSA	0.8
Children's Sleepwear Flammability Ban	CPSC	0.8
Auto Side Door Support Standards	NHTSA	0.8
Low Altitude Windshear Equipment & Training Standards	FAA	1.3
Electrical Equipment Standards (Metal Mines)	MSHA	1.4
Trenching and Excavation Standards	OSHA-S	1.5
Traffic Alert and Collision Avoidance (TCAS) Systems	FAA	1.5
Hazard Communication Standard	OSHA-S	1.6
Side-Impact Standards for Trucks, Buses, and MPVs (Proposed)	NHTSA	2.2
Grain Dust Explosion Prevention Standards	OSHA-S	2.8
Rear Lap/Shoulder Belts for Autos	NHTSA	3.2
Standards for Radionuclides in Uranium Mines	EPA	3.4
Benzene NESHAP (originally: fugitive emissions)	EPA	3.4

Source: Budget for Fiscal Year 1992, Table C-2, Part 2, p. 370.

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of which are sobering or much worse. It tries to show that many regulations fail a cost-benefit test, as Morrall, Viscusi, and others have demonstrated. It also tries to outline some of the complex causes of failure. These include private or legislative self-interest, simple confusion, and a range of self-defeating strategies—approaches that do not promote their own public-spirited goals, or that even make things worse. I agree with Crandall that the failures are both systemic and fundamental. Many of Crandall's negative assessments of regulatory performance are, in fact, described in my book.[14] I do not believe and never suggest "that regulation has generally protected us rather well at a fairly reasonable price."[15] I neither believe nor argue that bureaucratic overreaching "can be corrected by the appropriate judicial review."[16] To say that judges should resolve ambiguities in directions indicated by the constitutional backdrop, as well as by economic and democratic theory, is hardly to say that judges can solve current regulatory problems.

In the end, I am unsure whether Crandall and I disagree much on the facts. I have suggested that many regulations pass cost-benefit balancing. Crandall appears to demur; but with respect to cost-benefit analysis of current regulatory initiatives, such disagreements as we have mostly involve matters of emphasis, detail, and degree. I wonder whether Crandall disagrees with my substantive and structural suggestions. Certainly I doubt that he rejects the proposition that we should shift away from command-and-control regulation and toward economic incentives, informational remedies, and more decentralized approaches. Much of the difference between us may lie instead in the fact that Crandall believes that cost-benefit analysis exhausts the universe of appropriate commentary on the regulatory state, whereas I think that there are also important questions of first principles, democratic theory, constitutional law, and statutory interpretation.

NOTES

1. Cass R. Sunstein, *After the Rights Revolution* (Cambridge, Mass.: Harvard University Press, 1990).
2. See also idem, "Endogenous Preferences, Environmental Law," *Journal of Legal Studies* 22 (1993): 217–54; idem, "Preferences and Politics," *Philosophy & Public Affairs* 20 (1991): 1–43; and Richard Pildes and Cass R. Sunstein, "Reinventing the Regulatory State," *University of Chicago Law Review* 62,

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no. 1 (Winter 1995): 122, which discusses differences among expert, economic, and democratic approaches, and which evaluates informational and incentive-based approaches.

3. Crandall, 201.
4. See *After the Rights Revolution*, ch. 3.
5. Ibid., 111, 229–30.
6. James Heckman and Brook Paynor, "Determining the Impact of Federal Antidsicrimination Policy on the Economic Status of Blacks: A Study of South Carolina," *American Economic Review* 79 (1989): 138–73.
7. See Sunstein, *After the Rights Revolution*, 80–81, for a brief summary of an intriguing literature.
8. See Robert Crandall, *Regulating the Automobile* (Washington, D.C.: Brookings Institution, 1986).
9. See Robert Crandall, *Controlling Industrial Pollution* (Washington, D.C.: Brookings Institution, 1983).
10. W. Kip Viscusi, *Fatal Tradeoffs* (Cambridge: Cambridge University Press, 1993), 177.
11. Ibid.
12. See John Morrall, "A Review of the Record," *Regulation* (November/December 1986): 25–34; see also Stephen Breyer, *Breaking the Vicious Circle: Toward Effective Risk Regulation* (Cambridge, Mass.: Harvard University Press, 1993); Viscusi; Sunstein, *After the Rights Revolution*, ch. 3 and Appendix B. See also Randall Cutler and John Morrall, "Health-Health Analysis," *Journal of Risk and Uncertainty* 8 (1994): 43ff, at 55, describing eighteen important regulations that survive "health-health analysis," which measures health gains against health losses from decreased wealth.
13. Viscusi, 264.
14. See Sunstein, *After the Rights Revolution*, ch. 3.
15. Crandall, "Regulation and the Rights Revolution," *Critical Review* 7, nos. 2–3 (Spring-Summer 1993): 193–204, at 199.
16. Ibid.

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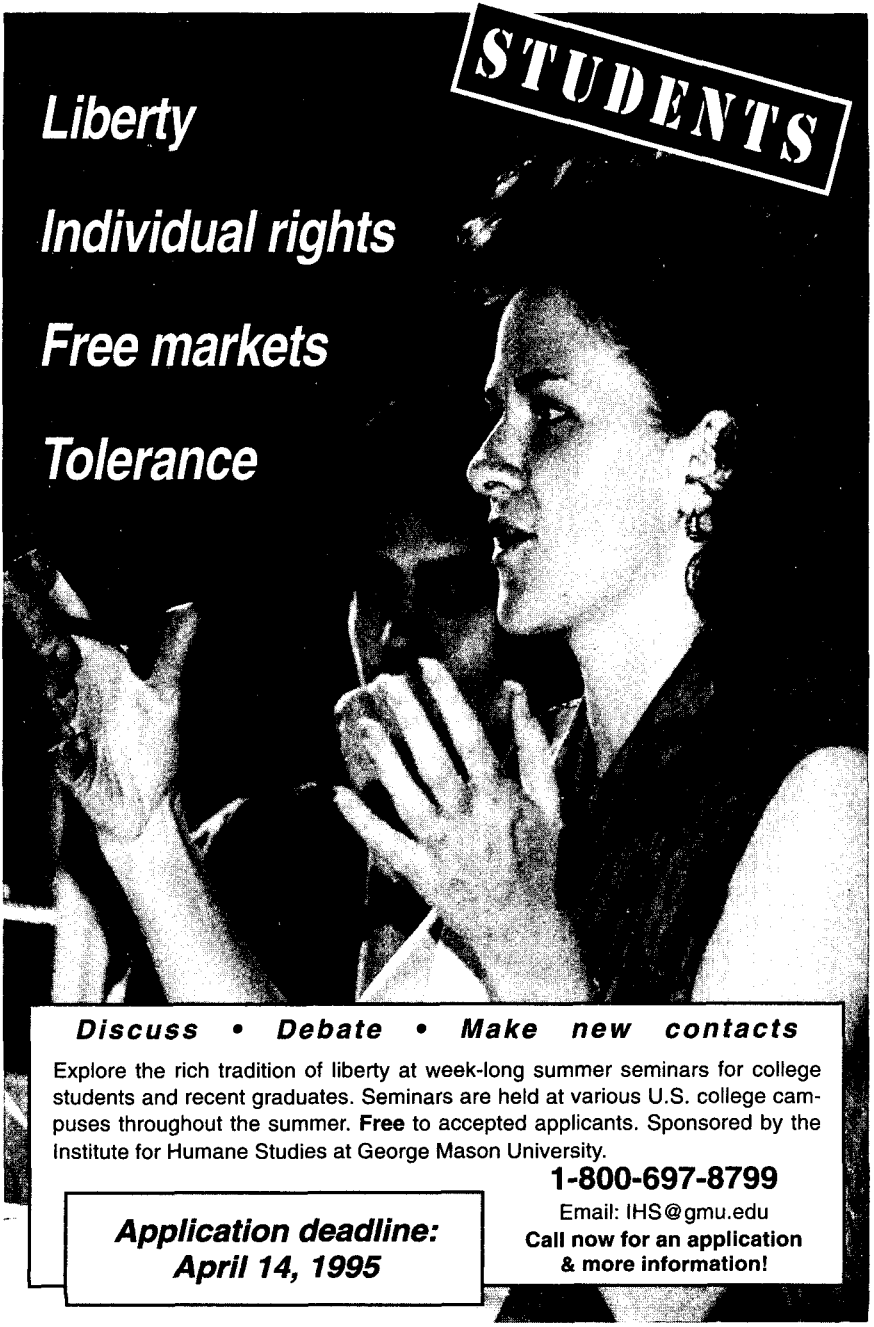

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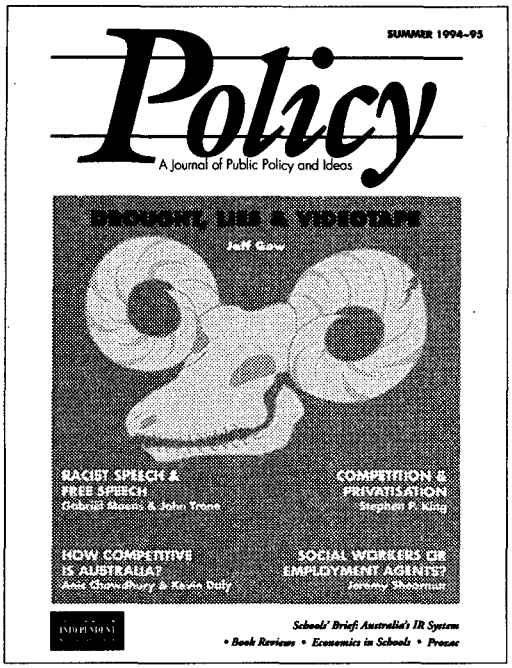
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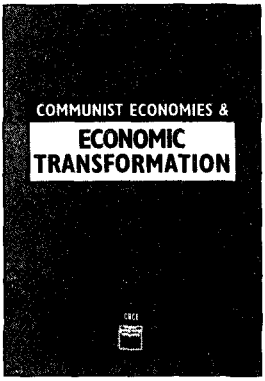

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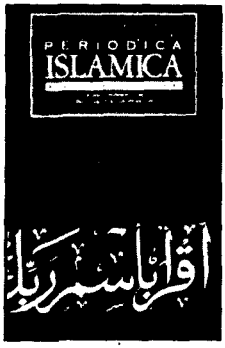

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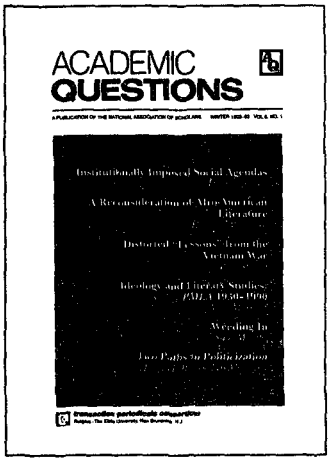

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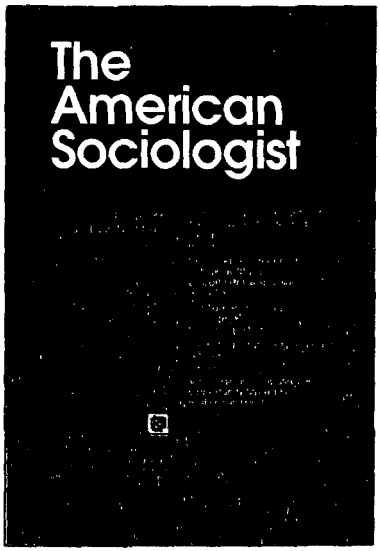

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In 1986, a small group of Platonic scholars met for the first Symposium Platonicum (on Plato's later dialogues) and formed the project of holding similar symposia on a triennial basis. The second Symposium, on the *Phaedrus*, duly took place in Perugia in 1989. During this meeting, the hundred or so scholars present established the International Plato Society.

The aim of the Society is to promote the study of Plato across the world, especially through the Symposia themselves, through the publication of the *Proceedings* of the Symposia, and through the dissemination of information about recent and current work on Plato. The Society owes no allegiance to any particular school or mode of interpretation. Full membership is open to any scholar who has published at least one substantial article - or completed a doctoral dissertation (or equivalent) - on Plato within the last fifteen years, and associate membership to anyone currently working towards a doctoral dissertation (or equivalent) in this field.

The Third Symposium Platonicum took place in late August 1992, in Bristol, on the subject of the *Politicus*. The meeting, which was attended by more than a third of the current membership of 350, saw the launch of the first volume in a new series, *International Plato Studies*: *Understanding the* Phaedrus. *Proceedings of the II Symposium Platonicum*, edited by L.Rossetti (Academia Verlag, Sankt Augustin: 328pp., hard cover, DM 98,-). The series will include not only the *Proceedings* of future Symposia, but also independent monographs on Plato, and reprints of books on Plato presently out of print. Scholars worldwide are invited to send their manuscripts to the President of the I.P.S., Professor Tomás Calvo, Universidad de Granada, Facultad de Letras, Departamento de Filosofía, Campus de Cartuja, E-18011 GRANADA, Spain.

All other correspondence, including applications for membership of the I.P.S., should also be sent to Professor Calvo.

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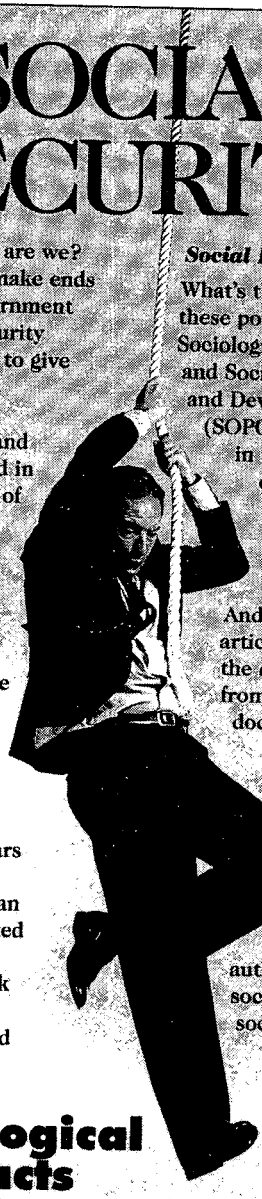

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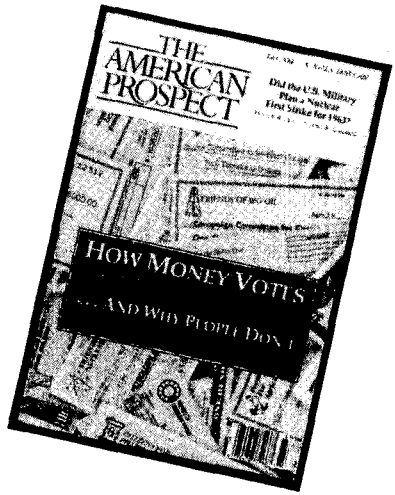

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